Supreme Court, U.S.
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No. 07-

IN THE

Supreme Court of the United States

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C.,

Petitioners,

– v. –

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

Pantelis Michalopoulos
Betty Jo Christian
Mark F. Horning
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
(202) 429-3000

E. Joshua Rosenkranz
Counsel of Record
Joanne M. Garvey
Eric Shapland
Jean-David Barnea
HELLER EHRMAN LLP
Times Square Tower
7 Times Square
New York, New York 10036
(212) 832-8300

Counsel for Petitioners

January 31, 2008

QUESTION PRESENTED

Consumers typically subscribe to television service through either of two means—cable or satellite. Cable companies hire legions of workers locally to lay cables and pay local governments significant franchise fees for valuable rights of way. Satellite providers build their significant infrastructure outside the boundaries of any particular state—in outer space. Kentucky has crafted a clever tax-and-subsidy scheme that favors the service that is intensely local while burdening the service whose infrastructure lies predominately out of state. Kentucky taxes both services, but uses the proceeds to defray a cost on behalf of cable companies, alone.

Does the practical effect of this tax-and-subsidy scheme discriminate against interstate commerce in violation of the Dormant Commerce Clause?

PARTIES TO THE PROCEEDING BELOW AND RULE 29.6 STATEMENT

The caption on this petition lists all parties to the proceeding before the Court of Appeals.

Petitioner DIRECTV, Inc. (DIRECTV) is an indirect wholly owned subsidiary of The DIRECTV Group, Inc., a publicly owned Delaware corporation. The DIRECTV Group, Inc. is approximately 41% owned by Fox Entertainment Group, a publicly owned Delaware corporation, which is wholly owned by News Corporation, also a publicly owned Delaware corporation.

Petitioner EchoStar Satellite L.L.C. (EchoStar) is an indirect wholly owned subsidiary of DISH Network Corp. (formerly known as EchoStar Communications Corp. and hereinafter "DISH"), a publicly owned Nevada corporation. DISH is controlled by Mr. Charles W. Ergen, an individual. Barclays plc, a company publicly traded on the London Stock Exchange, holds an indirect interest of approximately 10.5% in DISH through various subsidiaries. In addition, certain publicly traded mutual funds managed by Fairholme Capital Management, LLC, collectively hold an interest in DISH of approximately 10.5%.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit, dated May 31, 2007, is reported at *DIRECTV, Inc. v. Treesh*, 487 F.3d 471 (6th Cir. 2007), and is reproduced in the Appendix to this Petition (App.) at 1a-20a. The order of the Court of Appeals denying Petitioners' petition for rehearing en banc is unpublished, and is reproduced at App. 56a. The opinion of the U.S. District Court for the Eastern District of Kentucky, dated March 30, 2006, is reported at *DIRECTV, Inc. v. Treesh*, 469 F. Supp. 2d 425 (E.D. Ky. 2006), and is reproduced at App. 21a-55a.

JURISDICTION

The Court of Appeals entered an opinion on May 31, 2007, upholding the District Court's dismissal of Petitioners' complaint. A timely petition for rehearing en banc was denied on September 18, 2007. On November 29, 2007, Justice Stevens granted Petitioners an extension until January 31, 2008, to file this petition. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause provides: "The Congress shall have the Power ... [t]o regulate Commerce ... among the several States." U.S. Const. art. I., § 8, cl. 3. This case involves Kentucky Revised Statutes (KRS) §§ 136.602, 136.604, 136.616, 136.648, 136.650, 136.652, and 136.660, which are reproduced in relevant part, beginning at App. 57a.

INTRODUCTION

If Court of Appeals opinions came with headlines, this one would read like an obituary:

> "*West Lynn Creamery* Dead; Dormant Commerce Clause Gutted."

The Dormant Commerce Clause prohibits states from adopting taxing schemes that disproportionately burden out-of-state economic interests to give in-state economic interests a competitive edge. In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), this Court held that states may not achieve the same discriminatory result by sleight of hand: States may not, for example, adopt schemes that purport to collect taxes evenhandedly from in-state and out-of-state economic interests, but then turn around and use the very same funds to subsidize only the in-state interests.

The Court of Appeals has handed every state a roadmap by which to accomplish the same result: Instead of discriminatorily subsidizing the in-state interests by paying them cash, all the state must do is discriminatorily pay an expense on their behalf. The discriminatory effects are the same, and the evils are just as pronounced, but the Court of Appeals has held that this trivial adjustment insulates a discriminatory scheme from constitutional attack. This Court has never addressed whether its holding can be evaded so easily. But if this view of the law is correct, *West Lynn Creamery* is a dead letter, and states will clamor to apply this newfound license to indulge their most protectionist inclinations.

At the same time, the Court of Appeals has

gutted an even larger swath of Dormant Commerce Clause jurisprudence. It has held that a discriminatory law, no matter how blatantly protectionist in motive and effect, will survive Dormant Commerce Clause scrutiny so long as a court can imagine some additional benign motive for enacting the law—a holding that conflicts with decades of jurisprudence.

Depending on one's perspective, the obituary might be an occasion to mourn or to rejoice. But either way, if that is to be the result, the decision should come from this Court. The lower courts need this Court's guidance both to clear up confusion about how to apply Dormant Commerce Clause principles to subsidy schemes and to address other errors that undermine the Dormant Commerce Clause protections this Court has consistently articulated.

STATEMENT

Cable and Satellite Providers Engage in Different Levels of Local Activity and Investment

Consumers who wish to subscribe to a wide menu of television programs have two main choices: cable or satellite. From the consumer's perspective, both offer essentially the same service, referred to in the industry as "multichannel television programming service." But because the signals are delivered through different means, the two types of providers build different infrastructures. And those different infrastructures entail vastly different levels of local activity and local investment.

The infrastructure for cable service is intensely

local. To reach their subscribers, cable companies hire legions of workers within each state and invest heavily in building and servicing intricate webs of wires, underground and on utility poles. App. 3a. Businesses do not get to dig up roads and hang wires off utility poles for free. Cable companies pay local governments rent in the form of franchise fees, both for the valuable property rights and for the cost and disruption incident to installing and servicing their networks. App. 4a. Typically, the local government charges a franchise fee that is 5% of the gross revenue the cable company derives from subscribers within the locale. App. 23a; 47 U.S.C. § 542(b) (capping franchise fees at 5%). This fee, which is fairly ubiquitous, represents a significant cost of doing business—like rent, labor, and raw materials—which cable companies pass on to consumers. *See* Compl. ¶ 10.

In contrast, the infrastructure for distribution of satellite service is almost entirely outside any particular state—in outer space. App. 22a. Satellites are expensive to build, launch, and maintain. Over the past decade, satellite providers have invested over $1 billion in building their celestial infrastructure. App. 3a. But, for the most part, their investment does not flow locally. Satellite service does not require armies of local workers. *Id.* Nor can local governments extract franchise fees for rights of way, because satellite companies do not need to dig trenches or hang wires on public property. *Id.* Indeed, in part for that reason, Congress has made it illegal for local governments to charge satellite providers franchise fees. *See* Telecommunications Act of 1996, Pub. L. No. 104-104, § 602(a), 110 Stat. 56, 144 (1996) (codified at 47 U.S.C. § 152 note).

Consumers are largely agnostic about these differences in infrastructure. They do not care much whether their television signal travels through local cables or through airwaves from outer space. They care about what programs they can get and they care about price—a lot. *See* Andrew Stewart Wise & Kiran Duwadi, *Competition Between Cable Television and Direct Broadcast Satellite: The Importance of Switching Costs and Regional Sports Networks*, 1 J. Competition L. & Econ. 679, 702-03 (2005). Consequently, when satellite providers entered the picture, they introduced an element of price competition that had been missing for two decades, *id.* at 703, which is why Congress and the Federal Communications Commission (FCC) have both been intent on promoting satellite as a viable competitor to cable, *see infra* at 19-22.

States Promote Cable over Satellite with Discriminatory Taxes

States and local governments have been neither as agnostic to the mode of delivery as consumers, nor as receptive to the competition as federal authorities. The reason is simple: Cable's success translates directly into increased revenues for cash-starved local governments, more local jobs, and enhanced investment in local infrastructure. As the cable industry reports, it funnels $2.8 billion annually in franchise fees to local governments and employs 1.1 million "local workers." *See* Nat'l Cable & Telecomm. Ass'n, *2007 Industry Overview*, at 7 (2007), *available at* http://i.ncta.com/ncta_com/PDFs/NCTA_Annual_Report_04.24.07.pdf; Compl. ¶¶ 20-21. When satellite wins in the marketplace with a signal

beamed from space, the benefits to states and local governments diminish proportionately. From the perspective of states and local governments, it might as well be a battle between a cash cow and an alien invader with a taste for beef.

In the interest of reaping the local benefits, several states have devised a variety of mechanisms to advantage cable over satellite. Among their favorite tools have been discriminatory taxes. Some have been blatant. Ohio, for example, enacted an overtly discriminatory law that taxed only satellite and not cable. *See* Ohio Rev. Code § 5739.01(B)(3)(p). The tax reeked of local protectionism. As an Ohio court observed, an impetus for the statute was the argument that "the cable television industry employs many more people in Ohio, and ... has invested much more heavily in Ohio, than the ... satellite industry." *DIRECTV, Inc. v. Wilkins*, No. 03CVH06-7135, slip op. at 2 (Ohio Ct. C.P. Oct. 17, 2007) (unpublished). The court promptly struck the law as an impermissible discrimination against interstate commerce. The court noted that "the statute's different effects on the Satellite Companies and Cable Companies has everything to do with the geographic location of one of their economic activities." *Id.* at 53-54.

Other states have displayed the same parochial favoritism toward cable interests as Ohio, but devised craftier schemes. They reached the same discriminatory end by taking with one hand from both satellite and cable, and giving back with the other—whether in the form of a subsidy or a tax credit—but only to cable. *See, e.g.*, Fla. Stat. § 202.12(1)(a)-(b); N.C. Gen. Stat. § 66-351(a);

Tenn. Code Ann. § 67-6-714; Utah Code Ann. § 59-26-104.5; Va. Code Ann. § 58.1-662(A)-(C).[1]

Kentucky Imposes a Discriminatory Tax-and-Subsidy Scheme

This case is about one such circuitous route toward local protectionism, a law Kentucky passed in 2005. *See* 2005 Ky. Acts ch. 168, §§ 88-118 (codified at KRS §§ 136.600 to .660). Under the status quo before Kentucky enacted the legislation at issue here, the state imposed no tax on subscriptions to either satellite or cable. To be sure, local governments in Kentucky, as in virtually all other states, collected *franchise fees* from cable companies in return for cable's access to valuable local rights of way. But these franchise fees are as different from sales taxes as rent on a government-owned concession stand is from income taxes. App. 25a.

From this status quo, Kentucky accomplished its discriminatory subterfuge in two steps—a tax and a discriminatory subsidy—both enacted as part of the same legislation. Step one is a seemingly evenhanded tax. Kentucky imposed an excise and a gross-receipts tax totaling 5.4%, on all "multichannel video programming service"—

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[1] Petitioners have challenged most of these laws, as well. *See DIRECTV, Inc. v. Tolson*, __ F.3d __, 2008 U.S. App. LEXIS 450 (4th Cir. Jan. 10, 2008) (affirming dismissal of complaint on comity grounds); *DIRECTV v. Chumley*, No. 03-2408-IV (Tenn. Chan. Ct., Davidson County filed Aug. 19, 2003); *DIRECTV, Inc. v. Dep't of Revenue*, No. 372005CA-001037A00100 (Fla. Cir. Ct., Leon County filed May 4, 2005).

defined as "cable service and satellite broadcast and wireless cable service." KRS § 136.602(8); App. 5a. The excise tax—essentially a sales tax tacked onto each consumer's monthly bill—is 3% of the subscription price. KRS § 136.604(1)-(2). The gross-receipts tax is set at 2.4% of revenues derived from subscribers within the state. *Id.* § 136.616(2)(a). The revenues from both taxes are segregated into a special fund. *Id.* § 136.648(3).

Step two is the discriminatory subsidy: Kentucky allocates almost the entire segregated fund—collected from both cable and satellite providers—exclusively to the benefit of cable companies. The statute directs that virtually all of the funds be spent to pay cable's local franchise fees. *Id.* § 136.652 (distributing the special fund to local governments, except for a small fraction). The statute achieves this result through a transparent shell game: The law purports to prohibit local governments from levying franchise fees directly. *Id.* § 136.660(1). But it directs that the proceeds of the segregated fund flow directly to the local governments that would otherwise be entitled to the franchise fees—in proportion to the franchise fees they had historically been collecting. *Id.* §§ 136.648(3), 136.650(1)-(2), 136.652(2). In other words, local governments still pocket the franchise fee revenues they had always collected, but the state acts as their collection agent.

As if to shine a spotlight on the sleight of hand, the statute allows for the possibility that some local governments will continue to collect franchise fees directly from cable companies, *see id.* § 136.660(4), and directs that when that occurs, the cable companies will enjoy a full credit against their state

taxes, and the local government will not receive its allocation of the state taxes, *id.* § 136.660(5).

The net result is parochial favoritism with a faint patina of equality. Sure, cable and satellite providers now pay the same state tax. But the state uses the proceeds from the tax to subsidize cable—by paying a bill, on cable's behalf, that cable alone would otherwise pay for its purely in-state activities. Satellite providers, whose infrastructure and investment are entirely out of state, get no costs defrayed, because they are not subject to franchise fees. In short, Kentucky has now forced the customers of satellite providers to pay a tax that they never had to pay, and it uses this tax to subsidize a cost for cable alone. With this clever device, it drives down cable's costs, giving it a 5% price advantage over its satellite competitors.

Satellite Providers Challenge the Law

Petitioners DIRECTV and EchoStar are the two largest providers of satellite programming in the nation. They filed an action in federal court in Kentucky alleging that the Kentucky scheme violates the Dormant Commerce Clause.

The District Court dismissed the complaint, concluding that Petitioners could not establish a Dormant Commerce Clause violation. App. 21a.

The Court of Appeals affirmed the dismissal. It accepted all the facts alleged in the complaint as true. Thus, for purposes of this appeal, the following must be taken as fact: First, "the satellite companies ... employ inherently out-of-state facilities and have very little in-state infrastructure, while ... the cable companies ... employ necessarily expansive in-state facilities to

deliver their television service." App. 8a; *see* Compl. ¶¶ 16-17, 19-21. Second, under the Kentucky tax, "cable companies receive a tax preference because revenues from the state excise and gross revenues tax are used to pay the franchise fees that cable operators would otherwise have to pay local governments for access to local rights-of-way." App. 7a; *see* Compl. ¶¶ 25-30. Third, "[t]he satellite companies pay the new taxes, but [unlike cable] receive no relief from their operating costs." App. 8a; *see* Compl. ¶ 30.

Nevertheless, the Court of Appeals concluded that these facts could not, under any circumstance, make out a Dormant Commerce Clause violation. The Court of Appeals reasoned that the Kentucky tax differed from the unconstitutional tax-and-subsidy scheme of *West Lynn Creamery* in three ways: (1) the subsidy is not a "direct monetary subsidy," but is rather "only the right to conduct business and use local rights-of-way without local taxation or fees"; (2) satellite and cable are "distinct" products, "consisting of two very different means of delivering broadcasts," so there is no discrimination; and (3) in addition to its desire to favor cable for its in-state activities, the Kentucky Legislature might "possibly" have also been motivated by more benign goals. App. 19a.

The Court of Appeals denied a petition for rehearing en banc. App. 56a.

REASONS FOR GRANTING THE WRIT

I. KENTUCKY'S TAX-AND-SUBSIDY SCHEME RAISES A NOVEL DORMANT COMMERCE CLAUSE ISSUE.

The premise of this Court's Dormant Commerce Clause jurisprudence is that when the Constitution grants Congress jurisdiction over interstate commerce, it implicitly prohibits "economic protectionism" by and among the various states, as well. *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988). The "paradigmatic example" of an impermissible barrier to trade is the protective tariff—when a state imposes a higher tax on goods or services that came from out of state than on the same goods or services from within the state. *West Lynn Creamery*, 512 U.S. at 193. But in this area, substance matters more than the "form by which a State erects barriers to commerce." *Id.* at 201. Accordingly, this Court has struck other tax devices—however "ingenious"—that yield the same protectionist effect. *Id.* (internal quotation marks omitted).

Confusion persists, however, as to which tax devices, and combinations of devices, are impermissibly discriminatory and which are not, for this Court has "never held that *every* state law which obstructs a national market violates the Commerce Clause." *Id.* at 207 (Scalia, J., concurring) (emphasis added). The uncertainty is especially pronounced when seemingly evenhanded taxes—taxes that apply equally to in-state and to out-of-state activities—are coupled with *subsidies* that redound exclusively to the benefit of in-state interests. On the one hand, this Court has held

that states may "structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977), and as a general matter, they can promote in-state industry with cash subsidies, *see New Energy*, 486 U.S. at 278; *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809-10 (1976); *West Lynn Creamery*, 512 U.S. at 199 n.15; *id.* at 211 (Scalia, J., concurring). On the other hand, the last time this Court encountered a tax-and-subsidy scheme—14 years ago, in *West Lynn Creamery*—it struck a seemingly even-handed tax the proceeds of which were directed to subsidize only intrastate commerce.

In *West Lynn Creamery*, Massachusetts taxed milk wholesalers on their purchases of milk from both in-state and out-of-state producers. 512 U.S. at 190. This non-discriminatory tax had a discriminatory effect, however, because it was tethered to a cash subsidy: The tax went into a segregated fund, the proceeds of which subsidized only in-state milk producers. *Id.* at 190-91.

In ruling that this tax-and-subsidy scheme was impermissibly discriminatory, this Court did not articulate a clear line between a permissible subsidy to spur local growth and discriminatory protectionism. Even though it acknowledged that "'[d]irect subsidization of domestic industry does not *ordinarily* run afoul' of the negative Commerce Clause," *id.* at 199 n.15 (quoting *New Energy*, 486 U.S. at 278) (emphasis added), the majority opinion appeared to sweep broadly. It disapproved of a tax-and-spending scheme that "artificially encourag[es] in-state production even when the

same goods could be produced at lower cost in other States," or that "neutraliz[es] the advantage possessed by lower cost out-of-state producers." *Id.* at 193-94.

A bare majority of five Justices subscribed to the Court's rationale in *West Lynn Creamery*. In a concurrence, Justices Scalia and Thomas expressed discomfort with the breadth of the Court's reasoning on subsidies. They cautioned that "[t]he object should be ... to produce a clear rule that honors the holdings of our past decisions but declines to extend the rationale that produced those decisions any further." *Id.* at 210 (Scalia, J., concurring).

Both the breadth of the Court's opinion in *West Lynn Creamery* and the cautionary note about extending the doctrine have left lower courts with little guidance about how to assess other taxing schemes that are linked to subsidies. In the wake of *West Lynn Creamery*, prominent commentators bemoaned the uncertainty on "important questions about" when courts "should treat subsidies as freestanding exercises of the state's spending power, on the one hand, or as tax credits or exemptions, on the other," that can make an otherwise evenhanded tax impermissibly discriminatory. Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures*, 95 Mich. L. Rev. 2167, 2175 (1997).

They have variously noted that *West Lynn Creamery* "leaves serious doubts about the Court's view of tax-financed subsidy programs," Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax*

Incentives for Business, 110 Harv. L. Rev. 377, 443 (1996); urged the Court to "clarify its Commerce Clause jurisprudence," *id.* at 457; called for "a better justification for the formal line or an analysis that justifies the differing treatment of tariffs and subsidies on some basis other than a strictly formal one," Christopher R. Drahozal, *On Tariffs v. Subsidies in Interstate Trade: A Legal and Economic Analysis*, 74 Wash. U. L.Q. 1127, 1142 (1996); and lamented that "the difficult task of answering these questions must for now proceed unguided by any well-developed jurisprudential theory offered by the Supreme Court." Coenen & Hellerstein, *supra*, 95 Mich. L. Rev. at 2175; *see also* Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 Yale L.J. 965, 1003 (1998) (noting that "each of the three opinions"—including the dissent—in *West Lynn Creamery* "seeks to cast light" on the reasons why subsidies should be treated differently than discriminatory taxes, but that "none of these efforts meets with much success").

This Court recently took a case that could have clarified the principles and standards in these sorts of cases, but did not reach the merits for jurisdictional reasons. *See DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006). This case presents an opportunity free of jurisdictional obstacles.

In the absence of a "well-developed jurisprudential theory," the lower courts have adopted inconsistent approaches to taxes and subsidies—particularly when it comes to applying this Court's admonition that the Dormant Commerce Clause is not "so rigid as to be controlled by the form by which a State erects

barriers to commerce." *West Lynn Creamery*, 512 U.S. at 201. That directive has proven too general to be followed with consistency.

On the one extreme are courts that completely ignore form—courts that say (or behave as if) the "form by which a state erects barriers to commerce *has no effect* on the determination of whether discrimination exists." *Gen. Motors Corp. v. Dir. of Revenue*, 981 S.W.2d 561, 567 (Mo. 1998) (emphasis added) (striking limitation on right to file consolidated tax returns to affiliated companies that earn half of their income from in-state activities).

Others strive to comply with the substance-over-form directive by peering behind the form of the tax or the subsidy in search of guiding principles. They focus, for example, on such questions as whether the state has exercised its power to tax or subsidize in a manner that distorts market behavior, by favoring expenditures on in-state activities. *See Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738, 745 (6th Cir. 2004) (Ohio investment tax credit violates Commerce Clause because it can "encourage further investment in-state at the expense of development in other states"), *rev'd on other grounds*, 547 U.S. 332 (2006). Some find such a distortion in the market, even where the purported subsidy is highly indirect—just because the incentive made the out-of-state good a "less viable" option. *Alliance for Clean Coal v. Miller*, 44 F.3d 591, 597 (7th Cir. 1995).

On the other extreme are courts that seem to discount the "no-form-over-substance" directive, in an attempt not to risk extending existing

precedent. These courts treat the facts of *West Lynn Creamery* as a measuring rod, asking whether or not the scheme before them resembles the Massachusetts scheme this Court disapproved, with little regard for the underlying rationale. That is what the Sixth Circuit did in this case when it distinguished *West Lynn Creamery* on the ground that here, unlike there, "the claimed subsidy is not a direct monetary subsidy," App. 16a, without any analysis as to why it would matter whether the form of the subsidy is a cash payment or the payment of an obligation on behalf of the favored in-state industry.

This seems to be the dominant approach of courts that have addressed whether subsidies in the form of cash payments are treated differently from subsidies in the form of cost abatement. The First Circuit took the same approach in a case involving Puerto Rico's tax-and-subsidy scheme for the tire industry. *See Used Tire Int'l, Inc. v. Diaz-Saldana*, 155 F.3d 1 (1st Cir. 1998). The legislation taxed the importation of all tires and placed the proceeds into a fund used to cover the cost of recycling, processing, and exporting tires that are no longer usable. The proceeds, therefore, reduced costs that only the *local* dealers would face when disposing of used-up tires. The First Circuit rejected an analogy to *West Lynn Creamery* with the simple statement that Puerto Rico "does not subsidize local dealers at the expense of those engaged in interstate commerce." *Id.* at 5; *see also Diehl, Inc. v. Ohio Dep't of Agric.*, 806 N.E.2d 533, 536 (Ohio 2004) (upholding a fee on all milk purchases—from out-of-state and in-state milk producers, alike—even though the fee funded the costs of inspections for only in-state farms,

distinguishing *West Lynn Creamery* solely on the ground that "the Ohio fees are not a subsidy paid directly to the farmers but are instead collected to fund" the inspecting agency).

The Minnesota Supreme Court, too, placed significance in this distinction in upholding a municipality's tax-and-subsidy scheme on the waste industry. *See Zenith/Kremer Waste Sys. v. W. Lake Superior Sanitary Dist.*, 572 N.W.2d 300 (Minn. 1997). The municipality imposed a waste-management fee on all local waste, but used a portion of the proceeds to lower "tipping fees"—the fees that private waste haulers pay for the privilege of dumping waste at its local processing facility. The tax thus covered a portion of the costs associated with processing waste in the state, and burdened out-of-state processors by forcing them to pay some of those costs and compete at a price disadvantage. The Minnesota Supreme Court distinguished *West Lynn Creamery* because "[t]he use of the waste generation taxes to ... benefit[] users of the [processing] facility indirectly through lowered tipping fees, is a far cry from the direct cash subsidy found in *West Lynn*." *Id.* at 305.

Courts have not uniformly subscribed to this distinction between two types of subsidies. Both the trial and intermediate appellate courts in Minnesota reached the opposite conclusion. *See Zenith/Kremer Waste Sys. v. W. Lake Superior Sanitary Dist.*, 558 N.W.2d 288, 290-91 (Minn. Ct. App. 1997) (agreeing with trial court). Unlike the other courts, these courts looked behind the form of the subsidy, and focused on its effect. They recognized that "[h]aulers to out-of-state landfills pay the entire management fee, but do not receive

the 'rebate' that haulers to the [in-state] [f]acility receive through the ... reduced tipping fee." *Id.* at 291. "In effect, then," the "waste management fee" becomes a "tax [that] is imposed only on haulers to out-of-state landfills, and the ability of these haulers to lower their prices to compete with [the in-state facility] is impaired accordingly." *Id.*

This case presents this Court with an opportunity to provide much-needed guidance about exactly what makes a tax-and-subsidy scheme impermissibly discriminatory. In particular, this Court should resolve the open question whether a tax-and-subsidy scheme is beyond the reach of the Dormant Commerce Clause if the subsidy comes in the form of paying a cost on behalf of the local interests, rather than just putting cash in their pockets.

II. THIS CASE RAISES ISSUES OF NATIONAL IMPORTANCE.

It is important for this Court to intervene now for two reasons. First, the Court of Appeals' rationale is a roadmap for an end-run around the Dormant Commerce Clause's prohibition against discriminatory taxes and other forms of state economic protectionism. This Court has held that in order to preserve our unitary national economy, courts must treat a state tax as impermissibly discriminatory if the proceeds of the tax are directed toward paying a subsidy only for in-state activities. This rule will be a dead letter if a state can easily accomplish the same result by taking the money and returning it to the favored in-state taxpayer by a route other than a direct cash payment. If that is to be the law, it should be because this Court has so decreed, and not because

the lower courts are confused about the guiding principles.

Second, the Commerce Clause's goal—to protect barrier-free nationwide competition—is especially important in the market for television services. The sheer magnitude of the subscriber base—nearly 100 million American households—would be proof enough of a federal interest. *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 21 F.C.C.R. 2503, app. B, tbl.B1 (2006) ["FCC 2006 Annual Assessment"]. But the federal interest is all the more evident from the efforts Congress and the FCC have devoted to promoting satellite as a viable competitor to cable over the past several years.

For some 20 years, beginning in the late 1970s, any consumer who wanted to subscribe to a broad menu of television programming was stuck with one option—a local cable monopoly. *See* U.S. Gov't Accountability Office, No. GAO-05-257, *Direct Broadcast Satellite Subscribership Has Grown Rapidly, but Varies Across Different Types of Markets* 5 (Apr. 2005) ["GAO Report"], *available at* http://www.gao.gov. To the great dismay of consumers, cable took full advantage of its monopoly power, subjecting customers to ever-increasing price hikes bearing no relation to cable's costs. As Congress complained in 1992, the "average monthly cable rate ha[d] increased almost 3 times as much as the Consumer Price Index." Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(a)(1), 106 Stat. 1460, 1460 (1992) (codified at 47 U.S.C. § 521 note).

Congress felt compelled to react that year to the popular outcry over cable prices—overriding a presidential veto with overwhelming bipartisan support. Congress minced no words about the source of the problem: "Without the presence of another multi-channel video programming distributor, a cable system faces no local competition." *Id.* § 2(a)(2). "The result is undue market power for the cable operator as compared to that of consumers and video programmers." *Id.* Accordingly, Congress declared a priority to "increas[e] competition and diversity in the multichannel video programming market," and specifically to "increase the availability of ... satellite broadcast programming to persons in rural and other areas not currently able to receive such programming." *Id.* § 19, sec. 628(a), 106 Stat. at 1494 (codified at 47 U.S.C. § 548(a)). It did so by adopting measures to diminish the advantages cable enjoyed and to enhance the competitiveness of satellite broadcasters.[2]

Since then, Congress has thrice acted to overcome some of cable's artificial competitive advantages over satellite. In 1996, Congress prohibited local governments from putting their fingers on the scales of competition in specific ways. As noted above, Congress prohibited local governments from charging satellite providers

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[2] *See id.* sec. 628(b) (codified at 47 U.S.C. § 548(b)) (prohibiting cable from unfairly hindering other providers from transmitting certain kinds of programming); *id.* sec. 628(c) (codified at 47 U.S.C. § 548(c)) (prohibiting discrimination by cable-affiliated programmers against other providers).

franchise fees, *see* Pub. L. No. 104-104, § 602(a), 110 Stat. at 144, since satellite signals do not depend on the same intensely local infrastructure and rights of way as cable. Similarly, it directed the FCC to take further steps to prohibit local governments from restricting the installation of satellite dishes. *See id.* § 207(a), 110 Stat. at 114 (codified at 47 U.S.C. § 303 note). Congress also intervened in both 1999 and 2004 by leveling other advantages that cable enjoyed over satellite.[3]

The FCC, for its part, has also intervened time and again to enhance satellite's ability to compete fairly and fiercely with cable—sometimes anticipating Congress's interventions, sometimes embellishing upon them.[4] Indeed, a decade before Congress acted on the same issue, *see* Pub. L. No.

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[3] *See* Satellite Home Viewer Improvement Act of 1999, Pub. L. No. 106-113, div. B, app. I, § 1002, 113 Stat. 1501, 1501A-523 (codified at 17 U.S.C. § 122) (providing satellite the right to retransmit local network stations, like cable); Satellite Home Viewer Extension and Reauthorization Act of 2004, Pub. L. No. 108-447, div. J, tit. IX, §§ 102, 202, 118 Stat. 2809, 3393, 3409 (codified at 17 U.S.C. § 119(a) and 47 U.S.C. § 340, respectively) (same for retransmission of "significantly viewed" stations); H.R. Rep. No. 108-634, at 2 (2004) (identifying a purpose of the 2004 Act as to "increas[e] regulatory parity by extending to satellite operators the same type of authority cable operators already have").

[4] *See, e.g.*, *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 17 F.C.C.R. 12,124, ¶ 65 (2002) (prohibiting exclusive contracts between cable operators and cable-affiliated programming vendors); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 22 F.C.C.R. 17,791, ¶ 12 (2007) (same, five years later).

104-104, § 207, 110 Stat. at 114, the FCC itself took action to preempt state and local regulation of satellite dishes by holding that "[w]e will not permit a state to arbitrarily favor one particular communications service over another." *Preemption of Local Zoning or Other Regulations of Receive-Only Satellite Earth Stations*, 59 R.R.2d 1073, 1079 (F.C.C. 1986).[5]

These legislative and regulatory measures have slowly started to yield the desired results. Only in the past few years has satellite emerged as a viable rival to cable, *see* GAO Report, *supra*, at 5, expanding to 30% of the market, *see* FCC 2006 Annual Assessment, *supra*, ¶¶ 8-9; *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 17 F.C.C.R. 26,901, ¶ 58 (2002) (satellite broadcasting "has become the largest competitor to cable"). And with the proliferation of competition, predictably, has come price competition—to the benefit of the nearly 100 million households that subscribe to multichannel pay television services. *See* Wise & Duwadi, *supra*, 1 J. Competition L. & Econ. at 703.

These recent gains, however, are as incomplete as they are fragile. For one thing, cable prices have continued to rise above the rate of inflation,

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[5] *See also Preemption of Local Zoning Regulation of Satellite Earth Stations*, 11 F.C.C.R. 5809, ¶ 23 (1996) (preemption rule "assure[s] access to satellite signals and ... promote[s] competition between communications services"); *Preemption of Local Zoning Regulation of Satellite Earth Stations*, 11 F.C.C.R. 19,276, ¶ 6 (1996) ("The rule is designed to ... foster full and fair competition among different types of video programming services.").

culminating in yet another round of price hikes that the Chairman of the FCC condemned as recently as a few weeks ago. *See* Remarks of FCC Chairman Kevin Martin, *Rainbow Push Coalition, 11th Annual Wall Street Project Economic Summit* 1-2 (Jan. 9, 2008) ("The average cost of the expanded cable package (the standard cable package) almost doubled from 1995 to 2005—increasing 93%—while the cost of other communication services didn't just increase less, they *fell.*"), *available at* http://www.fcc.gov.

Why? Because, like any monopolist, cable has fought mightily to cling to any competitive edge. One of cable's most powerful competitive weapons is its political advantage in the states, where its legions of local employees and billions in local investment translate into clout in state legislatures—more clout than any enterprise that beams its signal in from outer space could hope to have. Cable has already deployed that political clout to pass discriminatory tax laws not just in Kentucky but in Florida, North Carolina, Ohio, Tennessee, Utah, and Virginia. *See supra* at 6-7. And it has recruited sponsors to introduce discriminatory tax bills in Iowa, Michigan, and New Jersey as well. S. File 390, 82nd Gen. Assem., Reg. Sess. (Iowa 2007); H.B. 4581, 94th Reg. Sess. (Mich. 2007); Assem. No. 3415, 212th Leg. (N.J. 2006). Emboldened by the Court of Appeals' opinion in this case, cable will undoubtedly pepper legislatures across the country with bills like these.

Cable is pressing these bills precisely because it understands that such tax discrimination at the state level can forestall further progress in reining in cable behavior, and indeed roll back the gains

Congress and the FCC have fostered. In competition this intense, every penny counts. In choosing between cable and satellite, rational consumers do not compare just the advertised base price. They compare the all-in price—how big a monthly check they have to write to get television service. *See* Jerry Brito & Jerry Ellig, *Video Killed the Franchise Star: The Consumer Cost of Cable Franchising and Proposed Policy Alternatives*, 5 J. Telecomm. & High Tech. L. 199, 218-19 (2006). Thus, the market is sensitive to taxes that directly increase the consumer's bill. *See* Wise & Duwadi, *supra*, 1 J. Competition L. & Econ. at 702-03. That is, of course, precisely why Congress prohibited local taxing jurisdictions from imposing franchise fees on satellite providers who do not need to dig ditches in the streets or hang wires on utility poles. *See* Pub. L. No. 104-104, § 602(a), 110 Stat. at 144. As cable providers well understand, giving cable a 5% price advantage over satellite in any state will cut deeply into satellite's competitive position. Proliferating this 5% price advantage across the country—or even just in a few key states—could scuttle all the gains that Congress and the FCC have worked so hard to foster.

The repercussions will extend beyond the market for television programming. Vindication of Kentucky's statute almost certainly means that states can discriminate against all manner of satellite-based services. States will be free to favor local radio stations over satellite radio providers (such as XM and Sirius), and to favor internet service that runs through cables or phone lines over satellite-based service (once the moratorium on taxing internet access expires). *See* Internet Tax Freedom Act, Pub. L. No. 105-277, § 1101(a),

112 Stat. 2681, 2681-719 (1998) (codified as amended, with expiration in 2014, at 47 U.S.C. § 151 note). All of these satellite-based technologies share the same political disadvantage that satellite television faces: less local political clout with which to battle local protectionism, because their distribution facilities are located outside the territorial confines of any state. *See infra* at 29-30.

Our nation has begun to see only a fraction of the benefits the public can derive from satellite-based technologies. The answer to the question whether states can sacrifice those benefits on the altar of local protectionism will have a profound impact on technological progress in this country for decades to come.

III. THE COURT OF APPEALS' DORMANT COMMERCE CLAUSE ANALYSIS IS DEEPLY FLAWED.

In distinguishing *West Lynn Creamery*, and concluding there could be no Dormant Commerce Clause challenge to Kentucky's tax-and-subsidy scheme, the Court of Appeals made three critical errors. First, it incorrectly resolved the primary question presented in this petition—whether subsidies must be treated differently when they come in the form of cost abatements rather than cash payments. Second, it incorrectly concluded that the discriminatory treatment of satellite is permissible because cable and satellite television are "distinct ... goods." Third, it concluded that a Dormant Commerce Clause violation can be excused so long as the state's discriminatory motive might arguably be accompanied by other non-discriminatory motives.

A. The Court of Appeals Erred in Distinguishing Between Two Sorts of Subsidies—Paying Cash and Covering Costs.

This Court has identified at least three tax devices that are impermissibly discriminatory. The first is the "paradigmatic example" mentioned above, when a state imposes a higher tax on goods or services from out-of-state than on the same goods or services from within the state. *West Lynn Creamery*, 512 U.S. at 193. The second is where the state imposes a seemingly evenhanded tax on an entire industry, but offsets the tax with a credit or an exemption for in-state businesses. Because the net effect is exactly the same as a tariff with greater burdens on out-of-state interests, these tax-and-credit schemes are impermissible as well. *See New Energy*, 486 U.S. at 274 (credit against fuel sales tax for in-state gasohol producers); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272 (1984) (exemption from sales tax for locally produced alcoholic beverages); *see, e.g., Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 400 (1984) (credit against income tax for increasing domestic shipping activities); *Maryland v. Louisiana*, 451 U.S. 725, 731-33 (1981) (exemptions and credits against first-use tax on natural gas for in-state use).

The third device—the scheme this Court disapproved in *West Lynn Creamery*—is where the state imposes "a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as 'rebates' or 'subsidies' to in-state members of the industry." 512 U.S. at 210 (Scalia, J., concurring).

As Justice Scalia observed, "[t]he only difference between [a] discriminatory 'exemption' from nondiscriminatory tax ... and [a] discriminatory refund of nondiscriminatory tax ... is that the money is taken and returned rather than simply left with the favored in-state taxpayer in the first place." *Id.* at 211 (Scalia, J., concurring). As this Court held, and the concurrence agreed, that distinction makes no practical difference. *Id.* at 197. Because this Court has "declined to attach any constitutional significance to such formal distinctions that lack economic substance," *Westinghouse Elec.*, 466 U.S. at 405, the sort of tax-and-subsidy scheme at issue in *West Lynn Creamery* is treated the same as the tax-and-credit schemes this Court had already disapproved. *See West Lynn Creamery*, 512 U.S. at 201.

The same point applies with equal force to the sort of tax-and-subsidy scheme at issue here. Kentucky's scheme, like the one this Court disapproved in *West Lynn Creamery*, is also "a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as ... 'subsidies' to in-state members of the industry." Like the improper tax-and-subsidy scheme in *West Lynn Creamery*, the Kentucky scheme draws equal taxes from in-state and out-of-state interests, alike. In both schemes, the taxes are placed into a segregated fund, and used to provide a subsidy that benefits only in-state interests, and not out-of-state interests. Either way, the in-state business enjoys a price advantage that is unavailable to the out-of-state business. And under either arrangement, the out-of-state interests are directly subsidizing that benefit. In short, as in *West Lynn Creamery*, "the

money is taken and returned rather than simply left with the favored in-state taxpayer in the first place." *Id.* at 211 (Scalia, J., concurring). The only difference is how the money is returned: Instead of returning the money by writing a check to the in-state taxpayer, Kentucky returns the money by paying a cost on behalf of the in-state taxpayer—essentially paying the favored taxpayer's rent directly to the landlord, instead of handing the taxpayer the rent money.

That distinction, too, makes no practical difference. A subsidy is a subsidy. There is no practical or economic difference between a subsidy in the form of a cash payment to an in-state interest and a subsidy in the form of paying a cost on the in-state interest's behalf. Thus, even under the narrowest interpretation of Dormant Commerce Clause principles—a "rule that honors the holdings of ... past decisions but declines to extend the rationale that produced those decisions any further," *id.* at 207-08 (Scalia, J., concurring)—the Kentucky tax-and-subsidy scheme should be struck for the same reason as the virtually identical scheme in *West Lynn Creamery*.

This practical conclusion is reinforced by the principles underlying *West Lynn Creamery* and other Dormant Commerce Clause cases. The taxing schemes that this Court has disapproved—whether "paradigmatic" or more "ingenious," *id.* at 193, 201—have all shared several features. In each, local producers benefit in the marketplace because their out-of-state competitors suffer price-increasing costs. The discrimination artificially sustains production by in-state producers who are less efficient than their out-of-state counterparts.

Investment is skewed towards the state because of the "distorting effects on the geography of production." *Id.* at 193. Prices rise. And the benefits of our "unitary national market" are lost. *Id.*

From the perspective of all the players—the state that collects and distributes the funds, the out-of-state interests that pay the tax without deriving any benefit, the in-state interests that reap all the benefit, and the consumers who pay more—Kentucky's scheme displays all the attributes that this Court has found objectionable. The effect on the national market is the same whether the subsidy to in-state activities comes in the form of a cash payment or cost abatement.

Kentucky's scheme also exhibits another attribute that this Court emphasized in *West Lynn Creamery*. It is an attribute that underscores why an integrated scheme like Kentucky's (one funded by earmarked funds derived in large part from out-of-state interests) is more troubling than a pure subsidy of the sort that is ordinarily permissible (a subsidy drawn from general revenues). A pure subsidy, this Court observed, reflects a legislative judgment that the state should make an investment in a particular industry. Because the funds derive from the entire state tax base, the state could not make that decision without building a broad political consensus. *Id.* at 200. In contrast, the burden of the tax-and-subsidy schemes both here and in *West Lynn Creamery* falls entirely on the unrepresented, out-of-state interests. *See id.* at 199 n.15; *id.* at 211 (Scalia, J., concurring); *see also New Energy*, 486 U.S. at 278; *Hughes*, 426 U.S. at 809-10.

This case presents a vivid illustration of the phenomenon. The Kentucky Legislature "mollified" the very group that would ordinarily have opposed the tax most vociferously. *West Lynn Creamery*, 512 U.S. at 200. Cable supported the new tax on its services precisely because the net effect of the scheme was to increase the costs of the political (and geographic) outsider relative to cable. Just as in *West Lynn Creamery*, "when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse." *Id.*

The Court of Appeals ignored all of this teaching from this Court's prior jurisprudence. It did so in part because it concluded that Kentucky was not actually making any payment on cable's behalf. The Court of Appeals correctly observed that "[s]tates and local government are under no mandate to charge for the use of local rights-of-way." App. 14a. But it was flatly wrong when it concluded that "the state has simply prevented localities from mulcting cable companies through franchise fees, and substituted a uniform state taxation scheme." App. 17a.

This assertion elides both the economic and political realities of the taxing scheme, in defiance, yet again, of this Court's instruction that courts must not be "so rigid as to be controlled by the form by which a State erects barriers to commerce," and cannot "divorce" components of an integrated scheme that, as a practical matter, are inseparable. *West Lynn Creamery*, 512 U.S. at 201. Politically, the Kentucky Legislature did not develop a consensus that local governments should

no longer receive compensation for their rights-of-way. That would have required legislators to fend off fierce opposition from local governments, which depend on that income stream both to cover the costs of digging up roads and maintaining utility poles, and to fund other services.[6] Instead, the Legislature merely agreed to change they way in which local governments receive compensation for use of their rights-of-way.

Accordingly, the state merely assumed the role of collection agent for local government franchise fees. The state collects the money from cable and satellite alike, puts it in a segregated fund, and then shifts the very same funds to the local governments in an amount sufficient to replace cable's franchise fees.

B. The Court of Appeals Failed to Recognize that It Is Impermissible to Favor Firms that Make Heavy In-State Investments over Firms that Do Not.

The Court of Appeals' second mistake was to

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[6] The Court of Appeals questioned the complaint's allegation that franchise fees compensate local governments for real economic costs associated with cable's method of distribution. App. 14a-15a. It should be obvious that renting municipal real estate is a transfer of value to the lessee (worth billions of dollars nationwide) and that digging up the roads is not exactly nuisance-free to the citizens. Thus, franchise fees are "essentially a form of rent: the price paid to rent use of public right-of-ways." *City of Dallas v. FCC*, 118 F.3d 393, 397-98 (5th Cir. 1997). In any event, this is not the sort of question that could be resolved on a motion to dismiss.

conclude that Kentucky's decision to favor cable over satellite is not discrimination against "interstate commerce." The court began with the assertion that television programming delivered by cable and television programming delivered by satellite are "two 'goods'" that "are distinct, consisting of two very different means of delivering broadcasts." App. 16a. From that premise, the Court of Appeals opined that, unlike in *West Lynn Creamery*, "the 'purpose and effect' of the tax and subsidy" was not "'to divert market share' from an out-of-state good to an *identical* in-state good," *id.* (quoting *West Lynn Creamery*, 512 U.S. at 203); rather, Kentucky was simply discriminating against a "particular ... *method*[] of operation" within the state, which is permissible, *id.* (citing *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978)) (emphasis added).

The court's premise is flawed. Cable and satellite are not two "distinct" goods or services. This Court has held that parties are "similarly situated" as long as they compete in the same market, even if their products have different characteristics. *See Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997). Under the correct analysis, what matters is not the mode of delivery, but the fact (as the complaint alleges) that cable and satellite are competing providers of the same service: multichannel video programming. Consumers are paying for the television programs. Kentucky, itself, has confirmed as much by imposing sales and revenues taxes on all "multichannel video programming service," which it defines to encompass "cable service and satellite broadcast" as indistinct services. KRS §§ 136.604, 136.616, 136.602(8).

Had the Court of Appeals not exaggerated the difference between cable and satellite, it would have been forced to conclude that Kentucky's discrimination is against interstate commerce. Petitioners can prove a Dormant Commerce Clause violation simply by demonstrating that Kentucky favors cable over satellite because cable transmission involves greater local economic activity, or, put another way, because cable uses a conduit that entails significantly greater investments and expenditures in the state.

That is what this Court means when it emphasizes that a state can violate the Dormant Commerce Clause when it discriminates against commercial activity for having "some interstate element," *Boston Stock Exch.*, 429 U.S. at 332 n.12, or when it puts in place "regulatory measures designed to benefit in-state *economic interests* by burdening out-of-state competitors," *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996) (emphasis added and internal quotation marks omitted); *see id.* at 330-33 (resident ownership of stock in corporations with out-of-state income); *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997) (in-state accommodations for out-of-state residents); *Westinghouse Elec.*, 466 U.S. at 403 (in-state business's exportation through out-of-state ports); *Maryland v. Louisiana*, 451 U.S. at 774-75 (in-state exploration and production of gas); *see also Cuno*, 386 F.3d 738 (locating machinery and equipment in another state).

This Court's analysis in *Boston Stock Exchange* illustrates the principle. The case involved a New York tax on stock transactions made within the state. 429 U.S. at 330-31. On certain stock

transactions, the law imposed a different tax depending upon the location of the exchange: a transaction through an out-of-state exchange would incur a higher tax than one through an in-state exchange. *Id.* The discriminatory tax protected the in-state infrastructure and tax base (the New York Stock Exchange) at the expense of the out-of-state infrastructure and tax base (emerging competitors like the Boston Stock Exchange). The state courts construed the protectionism as discrimination between two distinct kinds of interstate commerce, much as the Court of Appeals did here. *Id.* at 333.

This Court accepted that characterization, but still concluded that the tax impermissibly discriminated against interstate commerce. The evil, this Court held, was that "[t]he State is using its power to tax an in-state operation as a means of *requiring [other] business operations to be performed in the home State.*" *Id.* at 336 (emphasis added and internal quotation marks omitted).

Kentucky's scheme has a similar effect. Television programming that travels through local cables, and involves considerable local business activity and investment, gets the benefit of a subsidy; television programming that travels through outer space, and involves minimal local activity, gets no subsidy and is subject to a higher effective tax rate. The statute's purpose is to encourage the local activity. Here, as in *Boston Stock Exchange*, "[t]his diversion of interstate commerce and diminution of free competition in [television programming] sales are wholly inconsistent with the free trade purpose of the

Commerce Clause." *Id.*

C. The Court of Appeals Erred in Holding that a Protectionist Motive Can Be Excused if It Might Be Accompanied by Other Benign Motives.

The Court of Appeals' third mistake is the most far-reaching of all. The Court of Appeals acknowledged that "*a* purpose of the [Kentucky tax law] might have been to aid the cable industry rather than the satellite industry because the former has a larger in-state presence than the latter," but it excused the protectionist motive on the ground that "there were clearly *many other* purposes." App. 18a (emphases in original). The court then proceeded to posit a variety of possible purposes that "Kentucky may have wished to" achieve, even while acknowledging that "[n]one of these reasons are explicitly given by Kentucky in support of the [tax statute]." *Id.* The mere "possibility that [these hypothetical motives] in some way motivated the Kentucky legislature's actions" was enough to validate the discriminatory purpose. *Id.*

This notion—that a discriminatory state motive may be excused because one can hypothesize possible additional benign motives—is flatly inconsistent with this Court's precedents. If a taxing scheme is discriminatory in either purpose or effect, this Court has consistently required states to demonstrate that the discrimination is *necessary* to achieve a legitimate, non-discriminatory purpose. *See Granholm v. Heald*, 544 U.S. 460, 489 (2005); *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 352-53

(1977). This strict scrutiny applies whenever a statute discriminates in purpose or effect, because preventing states from purposely discriminating against interstate commerce is one of the Dormant Commerce Clause's fundamental purposes. *Cf. Maine v. Taylor*, 477 U.S. 131, 138 (1986) (noting that a lesser showing is required only when a scheme is not discriminatory in purpose or effect). By relying on hypothesized legislative purposes to uphold the Kentucky statute, the Court of Appeals substituted the laxest form of rational-basis review for the strict scrutiny that is required.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

Pantelis Michalopoulos
Betty Jo Christian
Mark F. Horning
STEPTOE & JOHNSON LLP
1330 Connecticut Ave., NW
Washington, DC 20036
(202) 429-3000

E. Joshua Rosenkranz
Counsel of Record
Joanne M. Garvey
Eric Shapland
Jean-David Barnea
HELLER EHRMAN LLP
Times Square Tower
7 Times Square
New York, NY 10036
(212) 832-8300

Counsel for Petitioners

APPENDICES

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C., *Plaintiffs-Appellants*,	
v.	No. 06-5523
MARK TREESH, COMMISSIONER FOR THE DEPARTMENT OF REVENUE FOR THE STATE OF KENTUCKY, *Defendant-Appellee.*	

Appeal from the United States District Court for the Eastern District of Kentucky at Frankfort.
No. 05-00024—Karen K. Caldwell, District Judge.

Argued: January 23, 2007

Decided and Filed: May 31, 2007

Before: BOGGS, Chief Judge; and MERRITT and MOORE, Circuit Judges.

COUNSEL

ARGUED: Pantelis Michalopoulos, STEPTOE & JOHNSON, Washington, D.C., for Appellants. Douglas M. Dowell, OFFICE OF LEGAL SERVICES FOR REVENUE, Frankfort, Kentucky, for Appellee. **ON BRIEF:** Pantelis Michalopoulos, Lincoln L. Davies, Mark F. Horning, STEPTOE & JOHNSON, Washington, D.C., Kenneth S. Handmaker, Bradley E. Cunningham, MIDDLETON REUTLINGER,

Louisville, Kentucky, for Appellants. Douglas M. Dowell, Laura M. Ferguson, OFFICE OF LEGAL SERVICES FOR REVENUE, Frankfort, Kentucky, for Appellee. Burt A. Braverman, Timothy P. Tobin, COLE, RAYWID & BRAVERMAN, Washington, D.C., Jackson W. White, Lexington, Kentucky, for Amicus Curiae.

OPINION

BOGGS, Chief Judge. Directv, Inc. and Echostar Satellite L.L.C., collectively "the satellite companies," appeal from the district court's dismissal of their claims against Mark Treesh, the Commissioner of the Department of Revenue for the state of Kentucky. The satellite companies seek a permanent injunction against certain provisions recently added to Kentucky's revenue statutes that afford cable television operators credits and other relief from state taxes assessed against both cable companies and the satellite companies. The satellite companies contend that these credits unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause of Article I of the Constitution. Because we find no constitutional violation, we affirm the judgment of the district court.

I

a. The Satellite and Cable Companies

The satellite companies provide multi-channel video programming to subscribers by means of satellites stationed above the Earth. The federal government auctioned the right to transmit on

certain electromagnetic frequencies, and the satellite companies paid more than $700 million for these rights. The satellite companies allege that they have further invested more than $1 billion in building, insuring, and launching their satellites. Subscribers in Kentucky receive the signals from these satellites by means of small satellite dishes mounted on or near their houses. According to their complaint, the satellite companies "employ no infrastructure in the State to transmit their signal directly to the subscriber and do not use public rights-of-way in providing service." The district court noted, however, that according to the *amicus curiae* brief of the Kentucky Cable Television Association ("KCTA"), the satellite companies do have "local receiving facilities" on the ground in Kentucky, which receive the signals of local broadcast stations and include them in their offerings with the channels sent by satellite. In their complaint, the satellite companies state that Directv has two sales employees in Kentucky and that EchoStar has six sales employees in Kentucky. The district court noted that, according to the KCTA, the satellite companies employ a "legion" of local contractors in Kentucky to sell their services and receiving dishes.

Cable companies, on the other hand, provide multi-channel video programming by means of cable networks located in Kentucky. Cable systems receive the programming that they retransmit to subscribers at local cable headends. The cable headends then transmit the programming to Kentucky subscribers by way of cables laid in trenches in or along roads or hung on utility poles in the state and connected to the subscribers' television sets and set-top boxes. In their

complaint, the satellite companies assert that cable companies must obtain local government permission to use roads and other rights-of-way in order to lay or string cable connecting their local distribution facilities to the subscribers' homes. Local governments typically provide this permission by franchise agreements and permits granted to the cable companies. The satellite companies assert that in return for permission to use public rights-of-way, the cable companies pay a franchise fee to the applicable local government that is typically five percent of gross revenue within the franchise area. The satellite companies characterize the franchise fee as "compensation to the local government for valuable rights granted by the franchise." The satellite companies allege that cable operators have a "strong local presence in Kentucky due to the employment of numerous Kentucky residents and the location of numerous offices and facilities within the state to provide service." Finally, the satellite companies allege that when a customer wishes to purchase a subscription to multi-channel television service, there are basically only two choices: cable or satellite.

b. The Changes to Kentucky's Tax Law

In March 2005, Kentucky amended its tax laws. *See* 2005 Ky. Acts 168, Ky. H.B. No. 272, 2005 Regular Session (2005) (the "2005 amendments") (relevant provisions codified at various sections of Chapter 136 of the Kentucky Revised Statutes).

Prior to the 2005 Amendments, neither the cable companies nor the satellite companies were required to pay Kentucky state sales tax. In addition, pursuant to § 602(a) of the federal

Telecommunications Act of 1996, the satellite companies, but not the cable companies, were and are exempt from all local taxes and fees. Pub. L. No. 104-104, Title VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Nevertheless, the Telecommunications Act explicitly reserves to states the powers the states themselves had to tax satellite companies. *Ibid.* Meanwhile, as stated above, the cable companies paid franchise fees to local governments.

The Kentucky legislature passed the 2005 Amendments in order to provide "a fair, efficient, and uniform method for taxing communications services sold" in Kentucky and to simplify "an existing system that includes a myriad of levies, fees, and rates imposed at all levels of government." KRS § 136.600(1), (3). The 2005 amendments became effective on January 1, 2006.

Section 90 of the 2005 Amendments imposes an excise tax on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in the state. KRS § 136.604(1). The amendments define "multichannel video programming service" as "cable service and satellite broadcast and wireless cable service." *Id.* § 136.602(8). The excise tax is 3% of the sales price charged for the service. *Id.* § 136.604(2). Section 96 of the 2005 Amendments imposes a 2.4% tax on a multichannel video programming service provider's gross revenues from service provided to people in Kentucky. *Id.* § 136.616(1), (2)(a). Together, these provisions effectively impose a 5.4% tax on total charges for either cable or satellite.

Section 112 of the 2005 Amendments establishes a gross revenues and excise tax fund. KRS § 136.648(1). All revenues from the taxes described above are to be deposited into this fund. The money in the fund is then to be allocated among the state and its political subdivisions, school districts, and special districts. *Id.* § 136.648(3). Under Section 113 of the 2005 Amendments, every "political subdivision, school district, special district, and sheriff's department" must certify to the Revenue Cabinet the total local franchise fees it collected from multichannel video programming service providers in fiscal year 2005. *Id.* § 136.650(1). This certified amount is then used to determine the monthly portion of the gross revenues and excise tax fund that will be distributed to each subdivision, school district, and special district. The 2005 Amendments provide that each will be assigned a percentage, called the "local historical percentage," which is based on the amount of the subdivision's certified collections as a proportion of the total certified amount of all collections of all parties participating in the fund. In return for their participation in this fund, the subdivisions must agree to relinquish any right to a franchise fee or tax on multichannel video programming services. *Id.* § 136.650(1)(b).

Pursuant to Section 118 of the 2005 Amendments, local governments are prohibited from levying any franchise fee or tax on a multichannel video programming service. KRS § 136.660. If a local government imposes or attempts to impose a franchise fee or tax, the local government may not receive any share of the proceeds of the excise and gross revenues taxes for the period that the imposition occurs. *Id.*

§ 136.660(4). Further, if a provider of a multichannel video programming service actually pays a franchise fee or tax with respect to the service, the provider is entitled to a credit against the state taxes due in the amount of the franchise fee or tax. *Id.* § 136.660(5).

c. The Satellite Companies' Complaint

The satellite companies allege that the provisions of the 2005 Amendments that "afford cable system operators credits against the state excise and gross revenues taxes and relief from franchise fees unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause." The satellite companies ask the court to declare KRS § 136.660(4), (5) unconstitutional. These are the subsections of the 2005 Amendments prohibiting local governments from levying franchise fees and taxes, denying local governments fund proceeds if they levy such fees, and crediting providers of multichannel video programming services for any such fees paid. In effect, they argue that if a state imposes uniform taxes on all multi-channel video programming providers, it also is constitutionally required that the state allow its localities and subdivisions to charge significant franchise fees.

The satellite companies argue that with the new provisions the cable companies receive a tax preference because revenues from the state excise and gross revenues tax are used to pay the franchise fees that cable operators would otherwise have to pay local governments for access to local rights-of-way. This discriminates against interstate commerce because cable companies, which provide service via infrastructure necessarily

located within the state, get the tax preference while satellite companies, which provide service via satellites inherently located outside of the state, get no tax preference. In other words, the cable companies pay the new taxes but get relief from a portion of their operating costs, i.e., the price paid for the right to provide cable service in the franchise area and rights of access to public rights-of-way. The satellite companies pay the new taxes, but receive no relief from their operating costs. According to the satellite companies, this constitutes discrimination against interstate commerce because the burdened entities—the satellite companies—employ inherently out-of-state facilities and have very little in-state infrastructure, while the benefitted entities—the cable companies—employ necessarily expansive in-state facilities to deliver their television service.

II

We review a grant of a Rule 12(b)(6) motion to dismiss *de novo*. *See, e.g., Golden v. City of Columbus*, 404 F.3d 950, 958 (6th Cir.), *cert. denied*, 546 U.S. 1032 (2005). "[A] Rule 12(b)(6) motion should not be granted unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Ricco v. Potter*, 377 F.3d 599, 602 (6th Cir. 2004) (quotation omitted). In reviewing a motion to dismiss, we construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff. *See Evans-Marshall v. Bd. of Educ.*, 428 F.3d 223, 228 (6th Cir. 2005). The defendant has the burden of showing that the plaintiff has failed to state a claim

for relief. *Carver v. Bunch*, 946 F.2d 451, 454-55 (6th Cir. 1991). While all the factual allegations of the complaint are accepted as true, "we need not accept as true legal conclusions or unwarranted factual inferences." *Gregory v. Shelby County*, 220 F.3d 433, 446 (6th Cir. 2000) (citation omitted).

III

The satellite companies first argue that the district court erred by relying on factual assumptions that were neither alleged in their complaint nor consistent with the complaint's allegations. The satellite companies argue that this improperly converted the motion to dismiss into a motion for summary judgment. Specifically, the satellite companies argue that the district court substituted its own factual assumptions, largely drawn from the KCTA *amicus* brief, for the factual allegations in the satellite companies' complaint, and that the district court faulted plaintiffs for not coming forward with evidence to support their allegations.

At some times in its opinion, the district court appears to have made factual assumptions that may be controverted. While the satellite companies alleged that they used no infrastructure whatsoever within the state to deliver programming, the district court found that "the mechanisms by which the ... Satellite Companies deliver programming lie partially outside of Kentucky and partially inside the state." The district court specifically pointed to the receiving dishes for local programming mentioned in the KCTA brief as an example of the in-state infrastructure. Further, the district court faults the

satellite companies for the lack of "evidence in the record" to support the principal places of business of the satellite and cable companies, and the failure of the satellite companies to "presen[t] any other evidence" from which the district court could conclude that cable companies are in-state economic interests.

If the district court's decision were actually predicated upon the above factual findings or the failure of plaintiffs to present the specified evidence, it would have been error. "[U]nder the notice pleading standard of the Federal Rules, courts are reluctant to dismiss colorable claims which have not had the benefit of factual discovery." *Evans-Marshall*, 428 F.3d at 228. Further, it does not appear that the satellite companies were given a "reasonable opportunity to present all material made pertinent to the issue" as required by Fed. R. Civ. P. 12(b) when a district court converts a motion to dismiss into a motion for summary judgment.

The district court's opinion, however, was not clearly predicated upon its additional factual findings or its finding of lack of evidence. Several of the district court's reasons for dismissal were not based on these additional findings. Therefore, ignoring the above flaws in the district court's opinion, the relevant question on appeal is whether the district court properly found that, even accepting all of the facts in the satellite companies' complaint as true, the complaint failed to demonstrate that the 2005 Amendments discriminate against interstate commerce.

IV

The Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States," U.S. Const. art. I, § 8, cl. 3, and the "negative" or "dormant" aspect of the Commerce Clause implicitly limits a state's right to tax interstate commerce. In *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977), the Court provided a concise exegesis of the dormant aspect of the Commerce Clause:

> [W]e begin with the principle that "[the] very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944). It is now established beyond dispute that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States ... [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States." *Freeman v. Hewit*, 329 U.S. 249, 252 (1946). The Commerce Clause does not, however, eclipse the reserved "power of the States to tax for the support of their own governments," *Gibbons v. Ogden*, 9 Wheat. 1, 199 (1824), or for other purposes ... rather, the Clause is a limit on state power. Defining that limit has been the continuing task of this Court. On various occasions when called upon to make the delicate

> adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. *E.g., Freeman v. Hewit* .... This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959).

Id. at 328-29.

A tax provision satisfies the requirements of the Commerce Clause if (1) the activity taxed has a substantial nexus with the taxing state; (2) the tax is fairly apportioned to reflect the degree of activity that occurs within the state; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to benefits provided by the state. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The satellite companies only challenge Kentucky's amended tax law on ground (3).

The Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336-37 (1977). The Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes. The Court has made it clear,

however, that a tax statute's "constitutionality does not depend upon whether one focuses upon the benefitted or the burdened party." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984).

In general, a challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face, or if, on the basis of a "sensitive, case-by-case analysis of purposes and effects," the provision "will in its practical operation work discrimination against interstate commerce," *West Lynn Creamery v. Healy*, 512 U.S. 186, 201 (1994) (citations omitted), by "providing a direct commercial advantage to local business." *Bacchus Imports*, 468 U.S. at 268 (citations omitted). "'Discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 99 (1994). A state tax provision that discriminates against interstate commerce is invalid unless "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at 101 (citation omitted).

A statute found to discriminate against interstate commerce "is virtually *per se* invalid." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (citation omitted). Once discrimination is shown, the heavy burden to prove the law's validity falls on the state. *See Maine v. Taylor*, 477 U.S. 131, 138 (1986).

On appeal, the satellite companies argue solely that the 2005 Amendments discriminate against interstate commerce in practical effect. *West Lynn Creamery*, 512 U.S. at 201. The satellite companies

complain that what they call the "tax and subsidy" approach, taken by Kentucky in the 2005 Amendments, is a sham. According to the satellite companies, while the Amendments purport to prohibit franchise fees from being assessed against all multi-channel broadcast services, in fact, only cable companies have been required to pay local franchise fees. Therefore, only they will benefit from this provision, while the satellite companies garner no benefit.

As an initial matter, the satellite companies do not contend that if Kentucky had solely imposed an equal state tax on both satellite companies and cable companies, without providing a credit for the cable companies' franchise fees or banning those fees, that such a tax would violate the Commerce Clause. Nor does it appear that Kentucky would have violated the Commerce Clause had it solely banned local governments from imposing franchise fees on cable companies. The nature of the franchise fees are somewhat disputed. As this case is before us on a motion to dismiss, we will accept the contention of the satellite companies that these franchise fees are at least compensatory in part; that they are collected in order to compensate the local governments for the cable companies' use of the rights-of-way, utility poles, etc. However, there is no allegation of any significant cost to the city of providing this access to the cable companies.

States and local government are under no mandate to charge for the use of local rights-of-way; this is readily apparent from the fact that not every road is a toll road. States have wide latitude "to encourage the growth and development of intrastate commerce and industry." *Boston Stock*

Exch., 429 U.S. at 336-37. The provision of access to the state infrastructure free of charge is an acceptable option that the state may exercise.[1] While the Supreme Court has struck down state regulations that charged out-of-state truckers and in-state truckers the same flat fees for the use of the state highways because the in-state truckers use the highways more frequently, *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 282 (1987), there is no indication that states would violate the Commerce Clause by foregoing such fees entirely, even though the lack of such a fee would benefit local truckers more than out-of-state truckers. *See West Lynn Creamery*, 512 U.S. at 199 n.15 ("[I]t is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads ...." (citing *Zobel v. Williams*, 457 U.S. 55, 67 (1982) (Brennan, J., concurring))).

Yet, as the Court has recognized in *West Lynn Creamery*, a tax and a subsidy, each of which would be constitutional standing alone, might together be unconstitutional. 512 U.S. at 199-200. The satellite companies analogize Kentucky's new taxation regime to the one found to violate the dormant Commerce Clause in *West Lynn Creamery*. In that case, Massachusetts required all milk dealers in the state to contribute to a price equalization fund regardless of whether they bought milk from in-state or out-of-state

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[1] The Court has indicated that even direct monetary subsidies to in-state companies often will not violate the Commerce Clause. *See West Lynn Creamery*, 512 U.S. at 199 n.15.

producers. The state then distributed the proceeds of that fund solely to Massachusetts dairy producers, but not to their out-of-state counterparts. The court found that this violated the Commerce Clause: "Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely ... offset by the subsidy provided exclusively to Massachusetts dairy farmers." *West Lynn Creamery*, 512 U.S. at 194. Massachusetts argued that either the tax or the subsidy standing alone would be constitutional, therefore, the combination must be constitutional as well. The Court rejected that contention, concluding that, even assuming that each component would be constitutional standing alone, "[b]y conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone." *Id.* at 199-200.

The instant case differs from *West Lynn Creamery* in several important respects. First, the claimed subsidy is not a direct monetary subsidy, but is instead only the right to conduct business and use local rights-of-way without local taxation or fees. Second, in *West Lynn Creamery*, the "purpose and effect" of the tax and subsidy was "to divert market share" from an out-of-state good to an identical in-state good. *Id.* at 203. In this case, however, the two "goods" are distinct, consisting of two very different means of delivering broadcasts. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978) (holding that the Commerce Clause does not "protect[] the particular structure or methods of operation in a retail market."). Further, the purposes of the 2005 Amendments include non-market share related goals, such as

simplifying the labyrinthine system of fees cable companies currently face and collecting taxes from the previously untaxed, burgeoning satellite industry.

The "paradigmatic example" of a law that violates the dormant Commerce Clause is the protective tariff, which taxes goods produced in other states but not those produced in-state. *West Lynn Creamery*, 512 U.S. at 193. Such tariffs are so clearly unconstitutional that states hardly ever enact them. *Ibid.* Yet other measures are the functional equivalent of such tariffs, such as enacting a facially neutral tax on all liquor and exempting liquor produced locally from the tax. *Bacchus Imports*, 468 U.S. at 263. In *West Lynn Creamery*, the Court found a tariff disguised as a tax and subsidy. The purpose and effect of that scheme was solely to raise the price of out-of-state milk and lower the price of in-state milk.

The satellite companies' allegations are insufficient to demonstrate that the 2005 Amendments create the functional equivalent of a protective tariff. With the Amendments, the state has simply prevented localities from mulcting cable companies through franchise fees, and substituted a uniform state taxation scheme. It has not otherwise altered any competitive balance among in and out-of-state competitors.

Further, a protective tariff is so clearly problematic because its only possible purpose is to benefit in-state interests at the expense of out-of-state interests—likewise an industry-specific tax and subsidy scheme. *See Note: Functional Analysis, Subsidies, and the Dormant Commerce Clause*, 110 Harv. L. Rev. 1537, 1552-54 (1997).

Unlike a protective tariff, however, the purposes of Kentucky's 2005 Amendments are much more diffuse. While *a* purpose of the Amendments might have been to aid the cable industry rather than the satellite industry because the former has a larger in-state presence than the latter, there were clearly *many other* purposes including assessing some tax against a satellite industry that is rapidly growing, and simplifying the current morass of local taxes and franchise fees that cable companies face. *See Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976) (upholding a state policy clearly motivated in part by a desire to improve the state's environment, despite any concurrent protectionist motivations). The satellite companies' opinion of the 2005 Amendments might be very different had they been subjected to the tangled regime of local taxation and franchise fees, as they certainly could have been absent the special exemption granted to them by the Telecommunications Act. 47 U.S.C. § 152, historical and statutory notes. Beyond that, because satellite and cable television differ significantly in their means of operation, Kentucky may have wished to remove any barriers it had put in place to the continued viability of cable for reasons entirely unrelated to geography—for example, that cable providers often provide internet access as well, that cable providers are more likely to provide public access channels, etc. None of these reasons are explicitly given by Kentucky in support of the Amendments, but the possibility that they in some way motivated the Kentucky legislature's actions is the reason that the Supreme Court has held that the dormant Commerce Clause is intended to protect interstate commerce, and not particular firms engaged in

interstate commerce, or the modes of operation used by those firms. *Exxon Corp.*, 437 U.S. at 126-28; *see also Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dep't of the Treasury*, 490 U.S. 66, 78 (1989) (holding that the differential tax treatment of "two categories of companies result[ing] solely from differences between the nature of their businesses, [and] not from the location of their activities" does not violate the dormant Commerce Clause.).

We must be cautious about applying the dormant Commerce Clause in cases that do not present the equivalent of a protective tariff. States must be allowed, and even encouraged, to work "to attract business by creating an environment conducive to economic activity." Applying the dormant Commerce Clause to invalidate Kentucky's revenue statute in this case would dramatically increase the clause's scope and limit states' "right to experiment with different incentives to business," *Alexandria Scrap*, 426 U.S. at 817 (Stevens, J., concurring), or to implement "effective and creative programs for solving local problems." *Reeves*, 447 U.S. at 441. Kentucky's banning of local franchise fees can serve many purposes and have many effects other than arguably reducing a cost previously borne by one type of competitor in the marketplace. After a "sensitive ... analysis of [the] purposes and effects" of the 2005 Amendments, we are unable to find that such action "will in ... practical operation work discrimination against interstate commerce." *West*

Lynn Creamery, 512 U.S. at 201.[2]

V

Accordingly, for the reasons set out above, we AFFIRM the district court's grant of Treesh's motion to dismiss.

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[2] Upon appeal, Treesh argues that Congress explicitly approved the type of taxation that Kentucky implemented with the 2005 Amendments. *See* 47 U.S.C. § 152, historical and statutory notes. Congress may authorize state regulation that would otherwise violate the dormant Commerce Clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992). Because we affirm the district court's judgment on other grounds, it is unnecessary for us to decide this question.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
FRANKFORT

CIVIL ACTION NO. 3:05-24

DIRECTV, INC., et al., PLAINTIFFS,

v. **OPINION AND ORDER**

MARK TREESH,
in his official capacity
as Commissioner of the
Department of Revenue, DEFENDANT.

**** **** **** ****

This matter is before the Court on the Motion to Dismiss (Rec. No. 10) filed by the Defendant, Mark Treesh (the "Commissioner"), who has been sued in his official capacity as Commissioner of the Kentucky Department of Revenue. The Plaintiffs, DIRECTV, Inc. and Echostar Satellite, LLC (the "Satellite Companies"), argue that recently enacted Kentucky corporate tax provisions unconstitutionally discriminate against interstate commerce by benefitting cable television operators (the "Cable Companies") and burdening the Satellite Companies. For the following reasons, the Court will GRANT the Motion to Dismiss.

I. FACTS.

A. The Satellite Companies.

The Plaintiff, DIRECTV is organized and headquartered in California. (Rec. No. 1, Complaint ¶ 6). The Plaintiff, EchoStar Satellite, LLC, is organized and headquartered in Colorado. (Rec. No. 1, Complaint ¶ 7). Neither plaintiff has

any offices located in Kentucky. (Rec. No. 1, Complaint ¶ 17).

The Satellite Companies provide multi-channel video programming to subscribers by means of satellites stationed above the Earth. (Rec. No. 1, Complaint ¶ 13). The federal government grants the Satellite Companies the right to transmit in certain electromagnetic frequencies from satellites located at certain orbital positions. (Rec. No. 1, Complaint ¶ 14). Subscribers in Kentucky then receive the signal from these satellites by means of a small satellite dish mounted on or near their house. (Rec. No. 1, Complaint ¶ 15).

In their Complaint, the Satellite Companies state that, because they do not use any public rights-of-way, they are not required to obtain franchise rights from local governments to operate in Kentucky. (Rec. No. 1, Complaint ¶ 16). In their brief as *amicus curiae*, the Kentucky Cable Telecommunications Association (the "KCTA") asserts that the Satellite Companies transmit the programming of local broadcast stations and that, in order to do this, they must have "local receive facilities" on the ground in Kentucky to receive the signals of local broadcast stations. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 18 n.7).

The Satellite Companies state that DIRECTV has two sales employees in Kentucky and EchoStar has six sales employees in Kentucky. (Rec. No. 1, Complaint ¶ 17). The KCTA asserts that, in addition to regular employees, the Satellite Companies employ a "legion" of local contractors in Kentucky to sell their services and receive dishes. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 18 n.7).

B. The Cable Companies.

The Cable Companies provide multi-channel video programming by means of cable networks located in Kentucky. (Rec. No. 1, Complaint ¶ 2). The Cable Companies receive programming at cable headends located in Kentucky and then transmit the programming to Kentucky subscribers by way of cables laid in trenches in or along roads or hung on utility poles in the state and connected to the subscribers' television sets and set top boxes. (Rec. No. 1, Complaint ¶ 18).

In their Complaint, the Satellite Companies assert that the Cable Companies must obtain local government permission to use roads and other rights-of-way in order to lay or string cable connecting their local distribution facilities to the subscribers' homes. (Rec. No. 1, Complaint ¶ 19). According to the Satellite Companies, local governments grant this permission by franchise agreements and permits granted to the Cable Companies. (Rec. No. 1, Complaint ¶ 19). The Satellite Companies assert that, in return for permission to use public rights-of-way, the Cable Companies pay a franchise fee to the applicable local government that is typically five percent of gross revenue within the franchise area. (Rec. No. 1, Complaint ¶ 20).

The KCTA asserts that the Cable Companies transmit national satellite-delivered programming, broadcast television signals and regional cable television network programming. In doing so, they rely on satellite transmissions, microwave relay stations and interstate fiber optic communications lines that beam their transmissions across state boundaries. (Rec. No. 28 Brief for KCTA as *Amicus*

Curiae at 15-17). *See also, Int'l Cablevision, Inc. v. Sykes*, 75 F.3d 123, 126 (2d Cir. 1996) ("Cablevision sells cable television programming which it delivers to its customers from the system headend via coaxial ground cable. The headend has parabolic or other appropriately shaped antennas for receiving satellite-delivered program signals, high-gain directional antennas for receiving distant TV broadcast signals, directional antennas for receiving local signals, machines for playback of taped programming and commercial insertion, and studios for local origination and community access programming.") (quotations and citation omitted).

The KCTA also asserts that the three largest cable companies in Kentucky are headquartered in states other than Kentucky. According to the KCTA, these companies are Insight Communications which is headquartered in New York, Adelphia Communications which is headquartered in Greenwood Village, Colorado and Charter Communications which is headquartered in St. Louis. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 16 n.6).

The Satellite Companies assert that the Cable Companies employ numerous Kentucky residents and have numerous offices and facilities in Kentucky. (Rec. No. 1, Complaint ¶ 21). The Satellite Companies assert that they are competitors of the Cable Companies in the market for multichannel video programming distribution. (Rec. No. 1, Complaint ¶ 22). According to the Satellite Companies, both the Cable Companies and the Satellite Companies sell various packages of television channels including local television stations and cable programming. (Rec. No. 1,

Complaint ¶ 22).

C. Situation Prior to the 2005 Amendments.

The legislation that is the subject of the Satellite Companies' Complaint was enacted by the Kentucky General Assembly in March, 2005. 2005 KY H.B. 272, Kentucky H.B. No. 272, 2005 Regular Session (Ky. 2005) (the "2005 Amendments") (relevant provision codified at various sections of Chapter 136 of the Kentucky Revised Statutes).

Prior to the 2005 Amendments, neither the Cable Companies nor the Satellite Companies were required to pay Kentucky state sales tax. In addition, pursuant to § 602(a) of the federal Telecommunications Act of 1996, the Satellite Companies were and are exempt from local taxes and fees. Pub. L. No. 104-104, Title VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Nevertheless, the Telecommunications Act explicitly permits states to impose a tax on the Satellite Companies and to distribute the proceeds from the tax to local governments. Pub. L. No. 104-104, Title VI, § 602(c), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Meanwhile, as discussed above, the Cable Companies paid franchise fees to local governments in return for franchise agreements permitting them to use road and other rights-of-way to lay or string cable. (Rec. No. 1, Complaint ¶ 19).

D. The 2005 Amendments.

With the 2005 Amendments, the legislature sought to provide "a fair, efficient and uniform

method for taxing communications services sold in this Commonwealth" and to simplify "an existing system that includes a myriad of levies, fees and rates imposed at all levels of government." 2005 KY H.B. 272 § 88(1), (3) (codified at KRS § 136.600(1), (3)). The relevant provisions of the 2005 Amendments became effective on January 1, 2006. 2005 KY H.B. 272 § 168.

1) Section 90—New Excise Tax on Purchasers.

Section 90 of the 2005 Amendments imposes an excise tax on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in the state. 2005 KY H.B. 272 § 90(1) (codified at KRS § 136.604(1)). The amendments define "multichannel video programming service" as "cable service and satellite broadcast and wireless cable service." 2005 KY H.B. 272 § 89(8) (codified at KRS § 136.602(8)). The excise tax is three percent of the sales price charged for the service. 2005 KY H.B. 272 § 90(2) (codified at KRS § 136.604(2)). The amendments require the provider to collect the excise tax from the purchaser. 2005 KY H.B. 272 § 91(1) (codified at KRS § 136.606(1)).

2) Section 96—New Gross Revenue Tax on Providers.

Section 96 of the 2005 Amendments imposes a 2.4 percent tax on a multichannel video programming service provider's gross revenues. 2005 KY H.B. 272 § 96(1), (2)(a) (codified at KRS § 136.616(1), (2)(a)). Unlike the excise tax, the provider is prohibited from collecting the 2.4 percent gross revenue tax directly from the

purchaser or to separately state the tax on the bill to the purchaser. 2005 KY H.B. 272 § 96(3) (codified at KRS § 136.616(3)).

3) Section 112—Creation of Designated Fund.

Section 112 of the 2005 Amendments establishes a gross revenues and excise tax fund. 2005 KY H.B. 272 § 112(1) (codified at KRS § 136.648(1)). All revenue from the gross revenues and excise tax imposed under Sections 90 and 96 are to be deposited into the fund. 2005 KY H.B. 272 § 112(3) (codified at KRS § 136.648(3)). The money in the new fund is to be allocated among the state, political subdivisions, school districts and special districts. 2005 KY H.B. 272 § 112(3) (codified at KRS § 136.648(3)).

4) Section 113—Portion of Designated Fund Distributed to Local Governments.

Under section 113 of the 2005 Amendments, each local government must certify to the Revenue Cabinet the local franchise fees it collected from communication services and multichannel video programming service providers and other fees collected to fund public educational and government access programming in Fiscal Year 2005. 2005 KY H.B. 272 § 113(1) (codified at KRS § 136.650(1)). This certified amount is then used to determine the monthly portion of the gross revenues and excise tax fund that will be distributed to each local government. 2005 KY H.B. 272 § 113(2) (codified at KRS § 136.650(2)).

Specifically, the amendments provide that each local government will be assigned a percentage, called the "local historical percentage," which is

based on the amount of the local government's certified collections as a ratio of the total certified amount of collections of all parties participating in the fund. 2005 KY H.B. 272 § 113(2)(a) (codified at KRS § 136.650(2)(a)). Each month, each local government is to be distributed an amount equal to its local historical percentage multiplied by the "monthly hold harmless amount." 2005 KY H.B. 272 § 113(2)(d) (codified at KRS § 136.650(2)(d)). The "monthly hold-harmless amount" is $3,034,000 which represents 1/12 of the total potential collections into the fund. 2005 KY H.B. 272 § 113(2)(c) (codified at KRS § 136.650(2)(c)).

In return for their participation in this fund, the local governments agree to relinquish any right to a franchise fee or tax on multichannel video programming services. 2005 KY H.B. 272 § 113(1)(b) (codified at KRS § 136.650(1)(b)).

5) Section 118—Local Franchise Fees Prohibited and Potential Tax Credit.

Pursuant to Section 118 of the 2005 Amendments, local governments are prohibited from levying any franchise fee or tax on a multichannel video programming service or from collecting any franchise fee or tax from providers or purchasers of multichannel video programming services. 2005 KY H.B. 272 § 118(1) (codified at KRS § 136.660). A "franchise fee or tax" is defined as:

> (a) any tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider, regardless of whether the tax, charge, or

> fee, is: 1) designated as a franchise fee, sales tax, excise tax, user fee, occupancy fee, subscriber charge, license fee, or otherwise; 2) measured by the amounts charged for services, the type or amount of equipment or facilities deployed, or otherwise; 3) intended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise; or 4) permitted or required to be separately stated on the purchaser's bill; or
>
> (b) Any in-kind payment of property or services that is required to be furnished by a provider by any ordinance that is enacted or agreement that is entered into after January 1, 2006.

2005 KY H.B. 272 § 118(2) (as codified at KRS § 136.660(2)).

If a local government imposes or attempts to impose a franchise fee or tax, the local government may not receive any share of the proceeds of the taxes levied by Sections 90 or 96 for the period that the imposition or attempt occurs. 2005 KY H.B. 272 § 118(4) (codified at KRS § 136.660(4)). Further, if a provider of a multichannel video programming service actually pays a franchise fee or tax with respect to the service, the provider is entitled to a credit in the amount of the franchise fee or tax against the amount due under Sections 90 or 96. 2005 KY H.B. 272 § 118(5) (codified at KRS § 136.660(5)).

E. The Satellite Company's Complaint.

With their Complaint, the Satellite Companies argue that the provisions of Section 118 of the 2005

Amendments that "afford cable system operators credits against the state excise and gross revenues taxes and relief from franchise fees unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause." (Rec. No. 1, Complaint, ¶ 32). The Satellite Companies ask the Court to declare unconstitutional only subsections 1, 4 and 5 of Section 118. (Rec. No. 1, Complaint, Prayer for Relief ¶ 1).

The Satellite Companies argue that, with the new provisions, the Cable Companies receive a tax preference because "revenues from the state excise and gross revenues tax [fund are used] to pay the franchise fee cable operators would otherwise have to pay local governments for access to local rights-of-way." (Rec. No. 13, Response at 3). The Satellite Companies argue that the tax provisions discriminate against interstate commerce because:

> [T]he availability of the tax preference depends on the geographic location of the facilities used to distribute television service. Cable companies, who provide service by local cable networks and pay franchise fees to local governments for that privilege, receive the preference. Satellite television companies, who provide services by satellites which are necessarily located out-of-state and pay the federal government for that privilege, do not receive the preference.

(Rec. No. 13, Response at 2).

> So, by paying the new taxes, cable systems defray one of their significant costs of

> doing business. By contrast, no benefit is available to satellite providers, because of the out-of-state character of their facilities. While the costs of building satellite systems and securing spectrum and orbital locations are substantial, these resources are not within the power of any municipality to give. Thus, the satellite providers receive no comparable benefits to those received by cable systems, despite making the same payments.

(Rec. No. 1, Complaint ¶ 5).

In other words, the Satellite Companies argue that, in return for paying the new taxes, Cable Companies receive a corresponding relief from a portion of their operating costs, i.e., the price paid for the right to provide cable service in the franchise area and for rights of access to public rights-of-way. The Satellite Companies, on the other hand, pay the new taxes but receive no relief from their operating costs. This constitutes discrimination against interstate commerce according to the Satellite Companies because the burdened entities—the Satellite Companies—employ out-of-state facilities to distribute television service, while the benefited entities—the Cable Companies—employ in-state facilities to distribute television service.

Thus, it appears that the Satellite Company's complaint is not just with the prohibition against local franchise fees found in Section 118 of the 2005 Amendments but is instead also with the new state taxes imposed under Sections 90 and 96 and the tax distribution system imposed under Section 113 by which a portion of the new taxes are

distributed to local governments in an amount proportionate to the amount the local governments previously collected in franchise fees. The Court will consider all of these provisions in determining whether Kentucky's new tax provisions violate the dormant Commerce Clause.

II. ANALYSIS.

On a motion to dismiss made pursuant to Fed. R. Civ. P. 12(b)(6), "the factual allegations in the complaint must be regarded as true. The claim should not be dismissed unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Scheid v. Fanny Farmer Candy Shops, Inc.*, 859 F.2d 434, 436 (6th Cir. 1988) (quoting *Windsor v. The Tennessean*, 719 F.2d 155, 158 (6th Cir. 1983)).

A. The Dormant Commerce Clause.

The Commerce Clause of the United States Constitution authorizes Congress to "regulate Commerce ... among the several States...." U.S. Const. art. I, § 8 cl. 3. "[T]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 402 (1984) (citation omitted). Thus, "[a]lthough the Commerce Clause is by its text an affirmative grant of power to Congress to regulate interstate and foreign commerce, the Clause has long been recognized as a self-executing limitation on the power of the States to enact laws imposing substantial burdens on such commerce." *South-Central Timber Dev. Inc. v. Wunnicke*, 467 U.S. 82, 87 (1984).

Favoring in-state economic interests over out-of-state economic interests is a classic means by which a state may discriminate against interstate commerce. In fact, the Supreme Court has repeatedly stated that "discrimination," for purposes of the Commerce Clause, "simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality of Ore.*, 511 U.S. 93, 99 (1994). Pursuant to these cases, states may not provide "a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). This is because, "[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the Clause protects." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). Such a result would be contrary to the fundamental objective of the dormant Commerce Clause which is to "preserv[e] a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors." *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 (1997).

A statute can discriminate against out-of-state interests in three different ways: (1) it may be facially discriminatory; (2) it may have a discriminatory intent; or (3) it may have a discriminatory effect. *Amerada Hess Corp. v. Director, Division of Taxation, New Jersey*, 490 U.S. 66, 75 (1989); *Eastern Ky. Resources v. Fiscal Court of Magoffin County*, 127 F.3d 532, 540 (6th

Cir. 1997) (citing *Wyoming v. Oklahoma*, 502 U.S. 437, 454-55 (1992)).

"State laws that discriminate on their face against interstate commerce are presumptively invalid." *Id.* at 532 (citing *Oregon Waste Sys. Inc.*, 511 U.S. at 99-100). "This is because these laws are almost always reflective of a state's attempt to isolate itself from the national economy and to protect local actors." *Id.* (citing *Fort Gratiot Sanitary Landfill Inc. v. Michigan Dep't of Natural Resources*, 504 U.S. 353, 361 (1992)).

B. Statute does not Facially Discriminate against Interstate Commerce.

Here, the statute does not discriminate on its face against out-of-state interests. The language of the new tax provisions do not distinguish between in-state and out-of-state economic interests. Instead, each of the relevant provisions evenhandedly applies to any multichannel video programming service provider. Accordingly, "there is no explicit discriminatory design to the tax." *Amerada*, 490 U.S. at 76.

C. The Satellite Companies Cannot Show that the Statute has a Discriminatory Purpose.

"It is axiomatic that a state law that purposefully discriminates against out-of-state interests is unconstitutional." *Eastern Ky. Resources*, 127 F.3d at 541. "The party challenging the validity of the regulation has the burden of demonstrating that the regulation has a discriminatory purpose." *Id.* "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature

undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases, we have followed their plain meaning." *Id.* (quoting *Perry v. Commerce Loan Co.*, 383 U.S. 392, 400 (1966)).

The only evidence in the record regarding the Kentucky legislature's intent with regard to the relevant provisions of the 2005 Amendments is found in the statute itself, which states that the new tax and distribution system:

> 1) Addresses an important state interest in providing a fair, efficient and uniform method for taxing communications services sold in this Commonwealth;
>
> 2) Overcomes limitations placed upon the taxation of communications service by federal legislation that has resulted in inequities and unfairness among providers and consumers of similar services in the Commonwealth;
>
> 3) Simplifies an existing system that includes a myriad of levies, fees and rates imposed at all levels of government, making it easier for communications providers to understand and comply with the provisions of the law;
>
> 4) Provides enough flexibility to address future changes brought about by industry deregulation, convergence of service offerings, and continued technological advances in communications; and
>
> 5) Enhances administrative efficiency for communications service providers, the

> state, and local governments by drastically reducing the number of returns that must be filed and processed on an annual basis.

2005 KY H.B. 272 § 88 (codified at KRS § 136.600). This language does not indicate any intent to protect local economic actors or to economically isolate the Commonwealth from the rest of the nation. *Eastern Ky. Resources*, 127 F.3d at 542. The Satellite Companies have presented no evidence that the new tax and distribution system was "motivated by an intent to confer a benefit upon local industry not granted to out-of-state industry." *Amerada*, 490 U.S. at 76.

Furthermore, even if the Satellite Companies could produce evidence that the legislature intended to burden them and to benefit the Cable Companies, this would not establish an intent to discriminate against interstate commerce. For reasons that will be explained further below, discrimination against satellite-delivered programming in favor of cable-delivered programming does not constitute discrimination against interstate commerce.

D. Statute Does not Have a Discriminatory Effect.

As to whether the new tax provisions have a discriminatory effect, for purposes of this motion, the court will presume that the new taxes and the distribution system imposed by the 2005 Amendments have the effect of burdening the Satellite Companies and benefitting the Cable Companies. Such an effect is, of course, irrelevant under the dormant Commerce Clause unless it constitutes discrimination against interstate

commerce. The Satellite Companies argue that, discrimination against them in favor of the Cable Companies has the effect of discriminating against interstate commerce because the Satellite Companies are "out-of-state" economic interests while the Cable Companies are "in-state" economic interests.

The plaintiffs bear the initial burden of showing that a statute has a discriminatory effect on interstate commerce. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). If the plaintiffs meet that burden, the Commissioner bears the burden of establishing that the challenged government action "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Oregon Waste Sys., Inc.*, 511 U.S. at 101.

The Satellite Companies argue that this case is similar to *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977). In *West Lynn Creamery*, the Supreme Court reviewed a Massachusetts statute that imposed a tax on all milk sold by dealers to Massachusetts retailers. 512 U.S. at 188. The tax collected was then distributed as a subsidy to Massachusetts dairy farmers. *Id.* The Supreme Court found that the statute's "avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States ... Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers." *Id.* at 194. Thus,

the Court found, "[l]ike an ordinary tariff, the tax is ... effectively imposed only on out-of-state products." *Id.* Accordingly, the Court found the statute unconstitutional because, "the purpose and effect of the pricing order are to divert market share to Massachusetts dairy farmers. This diversion necessarily injures the dairy farmers in neighboring States." *Id.* at 203.

In *Hunt*, the Court reviewed a North Carolina statute that prohibited closed containers of apples shipped into the State from bearing any grade other than the U.S. grade. 432 U.S. at 335. Washington State, the nation's largest apple producer, had developed its own grading system for apples that was equivalent to or superior to the U.S. grading system. *Id.* at 336. The Washington State Apple Advertising Commission argued that the North Carolina statute prohibiting the display of Washington State apple grades discriminated against interstate commerce. *Id.* at 335.

The Supreme Court determined that the challenged statute had the practical effect of not only burdening interstate sales of Washington apples but also discriminating against them. *Id.* at 350. First, it found that the statute forced Washington apple growers to alter their marketing practices in order to comply with the statute, unlike their North Carolina competitors. *Id.* at 351. "[T]he increased [costs of doing business] imposed by the statute would tend to shield the local apple industry from the competition of Washington apple growers and dealers...." *Id.* The Court also found the statute "has the effect of stripping away from the Washington apple industry the competitive and economic advantages it has earned for itself

through its expensive inspection and grading system." *Id.*

Finally, the Court found the statute would deprive Washington sellers of the market premium that apples sold under the superior Washington grades would otherwise command. *Id.* at 352. "Such 'downgrading' offers the North Carolina apple industry the very sort of protection against competing out-of-state products that the Commerce Clause was designed to prohibit." *Id.*

1) Statute does not Discriminate on the Basis of Geographic Location.

The entire premise of the Satellite Company's Complaint is that Kentucky's new tax provision benefits an alleged local interest, the Cable Companies, and burdens an alleged out-of-state interest, the Satellite Company. However, there is no evidence in the record regarding the principal places of business, states of incorporation or the states in which the Satellite Companies and the Cable Companies engage in economic activities. Nor have the Satellite Companies presented any other evidence from which the court can conclude that the Cable Companies are in-state economic interests.

The Satellite Companies assert that they are headquartered in states other than Kentucky and that they have no offices in Kentucky. The KCTA asserts that at least the four largest Cable Companies operating in Kentucky also are headquartered in states other than Kentucky. The parties assert that both the Cable Companies and the Satellite Companies have some employees in the state. Clearly, both engage in the economic

activity of selling video programming in the state.

Based on these undisputed assertions, the Cable Companies no more a "resident," "local," or "in-state" business than the Satellite Companies. Thus, regarding a statute that has different effects on the Satellite Companies and the Cable Companies, "there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply." *General Motors v. Tracy*, 519 U.S. 278, 300 (1997).

More importantly, however, regardless of their geographic location, it is clear that the alleged statutory burden imposed on the Satellite Companies has nothing to do with their residence or the location of their economic activities. While conceding that Kentucky's new tax provisions require both the Cable Companies and the Satellite Companies to pay new Kentucky taxes, the Satellite companies complain that the Cable Companies will be relieved of local franchise fees while the Satellite Companies will still be burdened with federal satellite transmission fees.

Even if a satellite company should move it headquarters to Kentucky, incorporate in Kentucky and deliver programming only in Kentucky, it would still suffer the burden of having to pay the federal government for the right to transmit via satellite. Furthermore, a cable company headquartered and incorporated outside of Kentucky would still not be required to pay the federal government for the right to transmit via satellite. The different effects of Kentucky's new tax provisions on Satellite Companies and Cable Companies are owed not to the geographic location

of the companies, but to their different delivery mechanisms. The Satellite Companies' alleged burden of having to pay the federal government for the right to transmit via satellite and having to compete with Cable Companies who do not have such an expense and who no longer have to pay local franchise fees falls equally on in-state and out-of-state Satellite Companies.

Thus, the statute has the same effects on the Satellite Companies and the Cable Companies whether or not a particular company is a domiciliary or resident of Kentucky. Because the statute "visits its effects equally upon both interstate and local business," *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 87 (1987) (quotations and citation omitted), it cannot be said to discriminate against interstate commerce on the basis that it benefits in-state economic interests and burdens out-of-state economic interests.

The Satellite Companies' Complaint is not aimed solely at the effects of Kentucky's new tax provisions. It is aimed at the combined effects of the state statute and federal laws that impose satellite transmission fees. As no party has raised the issue, the court will not address whether a state statute may be challenged under the dormant Commerce Clause on the basis that, when its effects are combined with those of federal law, an unconstitutional burden is imposed on interstate commerce. It is clear, however, that the Satellite Companies' real complaint is with federal fees that apply to them solely because they deliver programming by satellite, not because of their geographic location or that of their competitors.

2) The Dormant Commerce Clause Protects the Interstate Market, not Particular Delivery Mechanisms.

The Supreme Court has stated that the dormant Commerce Clause protects the interstate market for a particular product, but it does not protect "the particular structure or methods of operation in a retail market." *Exxon Corporation v. Governor of Maryland*, 437 U.S. 117, 127 (1978). Nor does it protect "particular interstate firms" operating in an interstate market. *Id.* Likewise, the Supreme court has held that "the Commerce Clause is not violated when the differential tax treatment of two categories of companies 'results solely from differences between the nature of their businesses, not from the location of their activities.'" *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 505 U.S. 71, 78 (1992) (quoting *Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dept. of Treasury*, 490 U.S. 66, 78 (1989)).

In *Amerada*, the Supreme Court reviewed a New Jersey statute that denied oil producers a state tax deduction for the federal "windfall profit tax" imposed on producers of crude oil. *Id.* at 68. The plaintiff oil companies argued that the deduction denial discriminated against oil producers who market their oil in favor of independent retailers who do not produce oil. *Id.* at 78. They argued that the state had singled out a business activity—oil production—conducted only in other jurisdictions for a special tax burden. *Id.* at 77. The Supreme Court noted that the state also denied tax deductions for the federal income tax which applied to corporations across the country.

Id. at 77. Thus, the Court determined that the deduction denial did not discriminate on the basis of geographic location and "whatever disadvantage this deduction denial might impose on integrated oil companies does not constitute discrimination against interstate commerce." *Id.* at 77-78.

The Court explained that the oil producing plaintiffs "operate both in New Jersey and outside New Jersey. Similarly nonproducing retailers may operate both in New Jersey and outside the State. Whatever different effect the [deduction denial] may have on these two categories of companies results solely from differences between the nature of their businesses, not from the location of their activities." *Id.* Thus, the Court determined that the statute did not discriminate against interstate commerce. *Id.* at 79.

Here too, as explained above, the statute's different effects on the Satellite Companies and Cable Companies has nothing to do with the geographic location of their economic activities. No matter where a satellite company operates, it is going to have to pay the federal government for the right to transmit via satellite. The statute's different effect on the Cable Companies and the Satellite Companies is not due to their geographic location. The different effect is due to the manner by which they deliver programming.

In *Exxon*, the Supreme Court reviewed a Maryland statute that prohibited oil producers or refiners from operating a retail service station within the state. 437 U.S. at 119. The statute was in response to complaints about inequitable distribution of gasoline among retailers in the state during the oil shortage of the 1970s. *Id.* at 121.

The state government had determined that gasoline stations operated by producers and refiners had received preferential treatment during the shortage. The statute thus required the major oil companies such as Exxon to divest themselves of their retail service stations in the state. *Id.*

There were no local oil producers or refiners so Exxon could not claim that the statute discriminated in favor of them. *Id.* at 125. Thus, Exxon focused on the retail market and argued that the statute protected in-state independent dealers in the gas retail market from out-of-state competition. *Id.* The Court noted that there were several major interstate marketers of petroleum that owned retail gas stations in Maryland but did not produce or refine gasoline. *Id.* at 125-26. These interstate marketers, like the oil refiners, competed directly with the in-state independent dealers but they were not affected by the statute. *Id.* at 126.

The Court held that, as to these marketers, the Maryland statute created no barriers. "[I]t does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between instate and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce." *Id.* at 126. "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Id.*

The Court recognized that, as a result of the statute, refiners may stop selling gasoline in

Maryland and that consumers may start purchasing gasoline from independent dealers instead of company-operated gas stations. *Id.* at 127. Nevertheless, the Court stated, "interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to s t from one interstate supplier to another." *Id.* at 127. The Court also recognized that consumers could be injured by the loss of high-volume, low-priced stations operated by the refiners. Nevertheless, the Court found that these results "relate[] to the wisdom of the statute, not its burden on commerce." *Id.* at 128. The Court rejected Exxon's "underlying notion that the Commerce Clause protects the particular structure or methods of operation in a retail market," stating that the dormant Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." *Id.* at 127-28.

In *Brown & Williamson Tobacco Corp. v. Pataki*, 320 F.3d 200 (2d Cir. 2003), the Second Circuit reviewed a New York statute that prohibited cigarette sellers from shipping cigarettes directly to New York consumers. *Id.* at 204. The district court had determined that the statute violated the dormant Commerce Clause because the only way an out-of-state seller could sell cigarettes to New York consumers was by establishing a store physically located in New York and this would be cost prohibitive for them. *Id.* at 212. Accordingly, the district court concluded that the statute effectively eliminated out-of-state direct sales retailers from the New York market by requiring face-to-face, instate retail sales only. *Id.*

The Second Circuit, however, found that, even if the only way that an out-of-state direct shipper could sell retail cigarettes to New Yorkers was to establish a brick-and-mortar outlet in New York, in-state direct shippers suffered the same burden as out-of-state direct shippers and, thus, the statute did not discriminate against out-of-state direct shippers. *Id.* Citing to *Exxon*, the court also determined that the fact that the particular plaintiff direct shippers may be priced out of the New York retail cigarette market did not establish a discriminatory effect because the fact that consumers may shift from one supplier to another does not subject interstate commerce to an impermissible burden. *Id.* at 213 (citing *Exxon*, 437 U.S. at 127-28). Citing to Exxon's holding that the Commerce Clause does not protect the particular structure or methods of operation in a retail market, the Second Circuit also determined that the New York statute, "merely prohibits one manner in which cigarettes could otherwise be sold to New York consumers, namely through direct shipments." *Id.* (citing *Exxon*, 437 U.S. at 127).

Thus, in *Amerada* and *Exxon*, the Court determined that the dormant Commerce Clause prohibits discrimination against the interstate market for retail gasoline but not specifically against retailers in that market who are oil producers. In *Brown & Williamson*, the Second Circuit relied on *Exxon* in finding that the dormant Commerce Clause prohibits discrimination against the interstate market for retail cigarettes, but not discrimination against retailers in that market who sell cigarettes in a particular manner.

In this case, the relevant market is the

interstate market for multichannel video programming and the relevant retailers are multichannel video programming service providers including those firms that deliver programming by satellite and those firms that deliver programming by cable. *See, e.g.*, Rec. No. 1, Complaint, ¶ 22 ("The relevant product market in which satellite and cable television companies compete is the market for multi-channel video programming distribution."). In accordance with *Exxon*, the dormant Commerce Clause prohibits discrimination against the interstate market for multichannel video programming, but it does not necessarily prohibit discrimination against programmers in that market who deliver programming by satellite as opposed to cable.

The Satellite Companies argue that this case is different from *Exxon* and *Amerada* because the " 'nature' of satellite and cable distribution is inextricably linked to geography." (Rec. No. 13, Response at 2, 3, 21). Thus, the Satellite Companies appear to argue, while in *Exxon* and *Amerada*, the Supreme Court held that discrimination based upon an out-of-state actors' method of operation or the nature of its business—as opposed to its geographic location—is not prohibited under the Commerce Clause, here such discrimination would be unconstitutional. This is because a satellite company necessarily delivers programming from satellites orbiting the earth and could never deliver programming from satellites located in the state. Cable Companies, on the other hand, necessarily deliver programming by means of cables located in the state. Thus, the Satellite Companies argue, in the interstate market for multichannel video programming, discrimination

against the economic actors that deliver programming by satellite necessarily constitutes discrimination based on the programming providers' geographic location.

In reality, however, the mechanisms by which both the Cable Companies and the Satellite Companies deliver programming lie partially outside of Kentucky and partially inside the state. In arguing that their transmission mechanisms lie totally outside of Kentucky, the Satellite Companies have arbitrarily considered only the location of their orbiting satellites. Even without considering whether the Satellite Companies utilize "local receive facilities" that are located in the state as the KCTA alleges, the Satellite Companies must concede that, in transmitting programming, they rely upon a multitude of receive dishes throughout the state.

It is also false that Cable Companies utilize only transmission facilities located in the state. Again, in determining the location of the Cable Companies' delivery mechanisms, the Satellite Companies have arbitrarily looked only to the cable headend and the cables laid or strung in the state. Before the cable programming ever gets from the cable headend to the subscribers, however, it is transmitted to the headend by out-of-state satellites and microwave systems.

More importantly, however, even assuming that the Satellite Companies' entire transmission system lies outside Kentucky and the Cable Companies' entire transmission system lies inside state, the Court finds no support for the proposition that the dormant Commerce Clause prohibits discrimination against particular means

of delivering a product when those means are "inherently" out-of-state. In *Amerada*, the issue was whether the New Jersey tax deduction denial discriminated against oil producers who are gasoline retailers in favor of local gasoline retailers who are not oil producers. 490 U.S. at 78. The Court specifically noted that the oil producers could not move their oil-producing activities to New Jersey because no oil reserves exist there. *Id.*

Thus, the oil-producing gas retailers in *Amerada* were as inherently "out-of-state" as satellite-delivering multichannel video programming providers. The Court considered this information as relevant only because it tended to show that the statute could not have been intended to induce the oil producers to move their oil-producing activities to New Jersey. Given this, the Court concluded, "it is difficult to see how [the statute] unconstitutionally discriminates against interstate commerce." *Id.* at 78; *see also id.* at 78 n.10 ("in the absence of discriminatory intent or a statute directed specifically at economic activity that occurs only in a particular location ..., a deduction denial does not unduly burden interstate commerce just because the deduction denial relates to an economic activity performed outside the taxing State.").

Exxon and *Amerada* make clear that the dormant Commerce Clause does not protect particular firms, particular methods of operation, or particular means of delivering a product. It protects interstate markets. Thus, whether the Satellite Companies' means of delivery are inherently out-of-state or not, in order to establish a violation of the dormant Commerce Clause, the

Satellite Companies must prove that the new Kentucky tax provisions discriminate against the interstate market for multichannel video programming. The Satellite Companies argue that they meet this burden simply by showing that some out-of-state actors—those delivering programming by satellite—are burdened by Kentucky's new tax provisions. *Exxon* and *Amerada* make clear that this is wrong.

3) The Statute does not Encourage Economic Activity in Kentucky or Discourage the same activity in other States.

The Satellite Companies argue that this case is similar to those in which the Supreme Court has held that a state violates the dormant Commerce Clause when it imposes "greater burdens on economic activities taking place outside the State than [are] placed on similar activities within the State." *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 403-04 (1984).

Thus, for example, in *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977), the Supreme Court reviewed an amendment to New York's stock transfer tax that provided a reduction in the tax on nonresidents if the transaction involved a sale in New York. *Id.* at 324. The Court explained that, prior to the amendment, the New York transfer tax was neutral as to in-state and out-of-state sales. An in-state transfer or delivery of securities triggered the tax and the burden fell equally on all transactions regardless of where the sale occurred. *Id.* at 330. Thus, "the choice of an exchange for the sale of securities that would be transferred or delivered in New York was not

influenced by the transfer tax; wherever the sale was made, tax liability would arise. The flow of interstate commerce in securities was channeled neither into nor out of New York by the state tax." *Id.*

As a result of the amendments, however, if a delivery or transfer of stock occurred in New York, the seller could "substantially reduce his tax liability by selling in State." *Id.* at 331. The Court determined that "[t]he obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges" in other states creating "both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister states." *Id.* The Court found that New York's use of its "power to tax an in-state operation as a means of 'requiring (other) business operations to be performed in the home state,'" was "wholly inconsistent with the free trade purpose of the Commerce Clause." *Id.* at 336.

In *Maryland v. Louisiana*, 451 U.S. 725 (1981), the Supreme Court reviewed a Louisiana statute that imposed a use tax on natural gas imported into in the state that had not already been taxed by another state or the federal government. *Id.* at 731. The tax owed was precisely equal to the state's severance tax imposed on Louisiana gas producers. *Id.* Since most states would have already taxed gas produced in their own state through severance taxes, the primary entities paying the Louisiana use tax would be those entities using gas produced from the federal outer continental shelf ("OCS") beneath the Gulf of Mexico and piped to processing plants in Louisiana. *Id.* at 731.

An owner paying the use tax on OCS gas received a credit on any state severance tax owed for gas produced in Louisiana. *Id.* at 756. The purpose of the tax was to equalize competition between gas produced in Louisiana and subject to the state severance tax and gas produced elsewhere that was not subject to the severance tax such as OCS gas. *Id.* at 732. The Court found that, "[o]n its face, this [severance] tax credit favors those who both own OCS gas and engage in Louisiana production." *Id.* at 756-57. The effect was to "encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other states." *Id.* at 756-77.

In *Westinghouse*, the Supreme Court reviewed a New York statute that provided an income tax credit for receipts based upon a company's export products shipped from New York. 466 U.S. at 393. The Court determined that the statute had the effect of allowing a greater tax credit as a company moves more of its shipping activities into New York and decreasing the tax credit as a company increases its shipping activities in other states. *Id.* at 400. Thus, the statute both "provide[d] a positive incentive for increased business activity in New York State" and "penalize[d] increases in the [company's] shipping activities in other states." *Id.* at 400-01.

The Court determined that the statute created "an advantage for firms operating in New York by placing a discriminatory burden on commerce to its sister States.'" *Id.* at 406. (quotations and citation omitted). The Court determined that the

New York statute "violated the prohibition in *Boston Stock Exchange* against using discriminatory state taxes to burden commerce in other States in an attempt to induce business operations to be performed in the home State that could be more efficiently performed elsewhere." *Id.* (quotations and citation omitted).

In each of these cases, the Court determined that the statute's effect was to encourage economic activity in the legislating state and to discourage that same activity in other states. There is not even an allegation here that Kentucky's new tax provisions would have the effect of encouraging any economic activity in Kentucky or discouraging that same activity elsewhere. The Satellite Companies argue only that the statute will encourage Kentuckians to switch to cable programming because it will be comparatively cheaper than satellite programming.

For the reasons discuss above, however, this does not establish an unconstitutional burden on interstate commerce. Again, there is no basis from which this Court can determine that cable-delivered programming is an industry any more local to Kentucky than satellite-delivered programming. Furthermore, the statute would inflict the same burden on an in-state satellite company as on an out-of-state satellite company and the same benefit on an out-of-state cable company as an in-state cable company. Finally, the fact that a statute would burden certain out-of-state firms does not establish a violation of the dormant Commerce Clause.

Thus, this is not a case where a state is encouraging the development of a local industry by

imposing greater burdens on economic activity taking place outside the state. In fact, the Satellite Companies have put forth no explanation as to how the state of Kentucky benefits by a statute favoring cable delivery over satellite delivery.

E. Pike Balancing.

Even though the statute does not directly burden interstate commerce, the Court must nevertheless proceed to a second tier of this analysis and determine whether the statute's potential benefits outweigh the burdens that the statute places on interstate commerce. *Eastern Kentucky Resources*, 127 F.3d at 544.

"Where [a] statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). "The party challenging the statue bears the burden of proving that the burdens placed on interstate commerce outweigh the benefits that accrue to intrastate commerce." *Eastern Kentucky Resources*, 127 F.3d at 545.

The Kentucky legislature has stated that the purpose of the statute is to provide a more fair, efficient, uniform and simple method for taxing communications services in the state. Again, the Satellite Companies argue they will be burdened by a cost disadvantage relative to the Cable Companies and that Kentuckians may switch from satellite-delivered programming to cable-delivered programming. Because the Satellite Companies

have not offered any evidence that the statute will have any effect on interstate commerce, the Court cannot find that the statute imposes a burden on such commerce that is clearly excessive to the putative local benefits.

III. CONCLUSION.

For all the above reasons, the Court hereby ORDERS that the Commissioner's Motion to Dismiss (Rec. No. 10) is GRANTED and this matter is STRICKEN from the active docket of this Court.

This 30th day of March, 2006.

SEAL: United States District Court
Eastern District of Kentucky

Signed by: Karen K. Caldwell/KKC
United States District Judge

No. 06-5523

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

DIRECTV, INC. ET AL. Plaintiffs-Appellants, v. MARK TREESH, COMMISSIONER FOR THE DEPARTMENT OF REVENUE FOR THE STATE OF KENTUCKY, Defendant-Appellee.	FILED SEP 18, 2007 LEONARD GREEN, Clerk ORDER

Before: BOGGS, Chief Judge; and MERRITT and MOORE, Circuit Judges.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT
s/[illegible]
LEONARD GREEN, Clerk/[initials]

RELEVANT STATUTES

Kentucky Revised Statutes §§ 136.602, 136.604, 136.616, 136.648, 136.650, 136.652, and 136.660 provide, in relevant part:

136.602. Definitions for KRS 136.600 to 136.660.

As used in KRS 136.600 to 136.660:

* * *

(8) "Multichannel video programming service" means cable service and satellite broadcast and wireless cable service;

* * *

136.604. Excise tax; multichannel video programming services; rate-sourcing rule.

(1) An excise tax is hereby imposed on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in this state, regardless of where or to whom those services are billed or paid.

(2) The multichannel video programming excise tax rate shall be three percent (3%) of the sales price charged for multichannel video programming service that is billed on or after January 1, 2006.

(3) Providers shall source multichannel video programming services to the end user's place of primary use.

* * *

136.616. Imposition of tax on gross revenues; multichannel video programming services and communications services; rates; collection of tax from purchaser prohibited; exclusion for municipal utility.

(1) A tax is hereby imposed on the gross revenues received by all providers.

(2) The tax rate shall be:

(a) Two and four-tenths percent (2.4%) of the gross revenues received for the provision of multichannel video programming service provided to a person whose place of primary use is in this state, billed on or after January 1, 2006; and

(b) One and three-tenths percent (1.3%) of the gross revenues received for the provision of communications services, as sourced under the provisions of KRS 136.605, billed on or after January 1, 2006.

(3) The provider shall not collect the tax directly from the purchaser or separately state the tax on the bill to the purchaser.

(4) (a) The tax imposed by this section shall apply to all providers except a municipal utility. "Municipal utility" as used in this section means a utility owned, operated, and controlled directly or indirectly by a city of the first, second, third, fourth, fifth, or sixth class.

(b) To the extent that the provisions of KRS Chapter 279 are inconsistent with KRS 136.600 to 136.660, KRS 136.600 to 136.660 shall control.

* * *

136.648. Gross revenues and excise tax fund and state baseline and local growth fund; creation and administration of funds.

(1) There is established in the State Treasury a gross revenues and excise tax fund. The fund shall be held and administered by the Finance and Administration Cabinet. The cabinet shall invest money in the fund in the same manner as money in the state general fund.

(2) There is established in the State Treasury a state baseline and local growth fund. The fund shall be held and administered by the Finance and Administration Cabinet. The cabinet shall invest money in the fund in the same manner as money in the state general fund.

(3) All revenue from the tax imposed under KRS 136.604 and 136.616, including all penalties and interest attributable to the nonpayment of the tax or for noncompliance with KRS 132.825 and 136.600 to 136.660 shall be deposited into gross revenues and excise tax fund. Amounts deposited in the gross revenues and excise tax fund shall be allocated among the state, political subdivisions, school districts and special districts as provided in KRS 136.648, 136.650, 136.652, 136.654, and 136.656.

(4) All money in the gross revenues and excise tax fund designated for distribution to political subdivisions under KRS 136.648, 136.650, 136.652, 136.654, and 136.656:

(a) Shall not be withheld or reduced by the General Assembly or any state agency for any reason, except for adjustments provided for within KRS 132.825 and 136.600 to 136.660; and

(b) Shall be used solely and exclusively for the provision of services to the general public, including public protection, health services, education, libraries, transportation services, and economic development. No amount shall be used for purely local purposes affecting only the inhabitants of the particular political subdivision, such as the administration of local government. Neither the General Assembly nor any state agency shall mandate how the funds are to be used.

* * *

136.650. Required participation in funds; computation of amounts; designated monthly hold harmless amount.

(1) (a) Every political subdivision, school district, and special district shall participate in the gross revenues and excise tax fund and the state baseline and local growth fund.

(b) On or before December 1, 2005, each political subdivision shall certify to the department on a prescribed form the amount of collections it received from the local franchise fees collected from communications service and multichannel video programming service providers and other fees collected to fund public educational and government access programming during the period between July 1, 2004, and June 30, 2005. By certifying its participation under this subsection, each political subdivision:

1. Consents to the hearing process provided in KRS 136.658; and

2. Agrees to relinquish its right to enforce the portion of any contract or agreement that requires the payment of a franchise fee or tax on

communications services and multichannel video programming services, regardless of whether the tax or fee is imposed on the provider or its customers.

(c) The amount of collections received by each political subdivision, school district, special district, and sheriff's department between July 1, 2004, and June 30, 2005, from the tax imposed by KRS 136.120 attributable to the franchise portion of the operating property, as noted in KRS 136.115, shall be calculated by the department from assessment data for calendar year 2004.

(2) The monthly portion of the gross revenues and excise tax fund that shall be distributed to political subdivisions, school districts and special districts under KRS 136.652 shall be computed as follows:

(a) Each political subdivision, school district and special district shall be assigned a percentage based on the amount of its collections certified under subsection (1) of this section as a ratio of the total certified amount of collections of all parties participating in the fund. This percentage shall be known as the "local historical percentage." The portion of the sheriff departments' certified collections identified in subsection (1) of this section from the tax imposed under KRS 136.120 attributable to the franchise portion of the operating property, as noted in KRS 136.115, that was imposed by county governments shall be added to each county's reported collections to determine its local historical percentage;

(b) The sheriff departments' collections certified under subsection (1) of this section that

are retained by the sheriff departments as their fee for collecting the taxes shall be the sheriff departments' fixed hold-harmless amount;

(c) Three million thirty-four thousand dollars ($3,034,000), which represents one-twelfth (1/12) of the total potential collections, shall be designated as the "monthly hold-harmless amount"; and

(d) Each political subdivision's, school district's, and special district's local historical percentage shall be multiplied by the monthly hold-harmless amount to determine its monthly distribution from the fund.

(3) If during the period between June 30, 2005, and December 31, 2005, any political subdivision had a substantial change in its base revenue by enacting or modifying the rate of a local franchise fee prior to June 30, 2005, the political subdivision may request the department to determine its certified collection amount.

(4) If any political subdivision, school district, special district, or sheriff's department believes that the data used to determine its certified amount of collections are inaccurate, the political subdivision, school district, special district, or sheriff's department may request a redetermination by the oversight committee established by KRS 136.658. A redetermination shall be effective prospectively beginning with the next distribution cycle occurring ninety (90) days after the matter is finally settled.

* * *

136.652. Distribution; administrative costs; monthly hold harmless amounts.

Money in the gross revenues and excise tax fund shall be distributed monthly as follows:

(1) One percent (1%) shall be deposited in a trust and agency account created in the State Treasury to be used by the department for administration costs associated with the implementation, collection, and distribution of the tax imposed by KRS 136.604 and 136.616.

(2) After the distribution required under subsection (1) of this section, the department shall distribute to each political subdivision, school district and special district the applicable monthly hold-harmless amount as calculated under KRS 136.650. In addition, the department shall distribute one-twelfth (1/12) of the sheriff department's fixed hold-harmless amount as defined in KRS 136.650(2)(b). For tax collections received in January and February of 2006, the department shall make the distribution by April 25, 2006. For all other periods, the department shall make distribution by the twenty-fifth day of the next calendar month following the tax receipts.

(3) After the distribution required by subsection (2) of this section, the department shall deposit one million two hundred fifty thousand dollars ($1,250,000) in the state general fund. This amount shall be adjusted on a prospective basis after the collection of the first twelve (12) months of tax receipts from the taxes imposed by KRS 136.604 and 136.616 to equal the average monthly tax receipts attributable to the taxation of satellite broadcast and wireless cable services

under KRS 136.604 and 136.616. The amount shall then become the fixed amount distributed to the general fund.

(4) Money remaining in the gross revenues and excise tax fund after the distribution required by subsection (3) of this section shall be transferred to the state baseline and local growth fund established in KRS 136.648.

* * *

136.660. Prohibitions; local franchise fee or tax defined.

(1) Except as provided in subsection (3) of this section, to the extent legally permissible, every political subdivision of this state shall be prohibited from the following:

(a) Levying any franchise fee or tax on multichannel video programming service or communications service, or collecting any franchise fee or tax from providers or purchasers of multichannel video programming service or communications service;

(b) Requiring any provider to enter into or extend the term of any provision of a franchise or other agreement that requires the payment of a franchise fee or tax; or

(c) Enforcing any provision of any ordinance or agreement to the extent that the provision obligates a provider to pay to the political subdivision a franchise fee or tax.

(2) For purposes of this section, "franchise fee or tax" means:

(a) Any tax, charge, or fee, that is required

by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider, regardless of whether the tax, charge, or fee, is:

1. Designated as a franchise fee, sales tax, excise tax, user fee, occupancy fee, subscriber charge, license fee, or otherwise;

2. Measured by the amounts charged for services, the type or amount of equipment or facilities deployed, or otherwise;

3. Intended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise; or

4. Permitted or required to be separately stated on the purchaser's bill; or

(b) Any in-kind payment of property or services that is required to be furnished by a provider by any ordinance that is enacted or agreement that is entered into after January 1, 2006.

* * *

(4) Notwithstanding any provision of law to the contrary, if a political subdivision imposes or otherwise attempts to require the payment of a franchise fee or tax, the political subdivision shall not receive any share of the proceeds of the tax levied by KRS 136.604 or 136.616 for the period that the imposition or attempt occurs.

(5) To the extent that a provider actually pays a franchise fee or tax with respect to multichannel video programming service or communications service that is also subject to the taxes imposed by KRS 136.604 or 136.616, the provider shall be

entitled to a credit against the amount payable to the department under KRS 136.604 and 136.616 in the amount of the franchise fee or tax, up to the amount of the total tax due with respect to the multichannel video programming service and communications service provided in that political subdivision, school district, or special district.

* * *

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